SOCIAL SECURITY FINANCING AND OPTIONS FOR THE FUTURE

HEARING

BEFORE THE

SUBCOMMITTEE ON SOCIAL SECURITY AND INCOME MAINTENANCE PROGRAMS

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

FIRST SESSION

JULY 10, 1981

Printed for the use of the Committee on Finance

PART 2 OF 2

U.S. GOVERNMENT PRINTING OFFICE
84-079 O WASHINGTON : 1981 HG 97-38

S361-79

COMMITTEE ON FINANCE

ROBERT J. DOLE, Kansas, *Chairman*

BOB PACKWOOD, Oregon
WILLIAM V. ROTH, JR., Delaware
JOHN C. DANFORTH, Missouri
JOHN H. CHAFEE, Rhode Island
JOHN HEINZ, Pennsylvania
MALCOLM WALLOP, Wyoming
DAVID DURENBERGER, Minnesota
WILLIAM L. ARMSTRONG, Colorado
STEVEN D. SYMMS, Idaho
CHARLES E. GRASSLEY, Iowa

RUSSELL B. LONG, Louisiana
HARRY F. BYRD, JR., Virginia
LLOYD BENTSEN, Texas
SPARK M. MATSUNAGA, Hawaii
DANIEL PATRICK MOYNIHAN, New York
MAX BAUCUS, Montana
DAVID L. BOREN, Oklahoma
BILL BRADLEY, New Jersey
GEORGE J. MITCHELL, Maine

ROBERT E. LIGHTHIZER, *Chief Counsel*
MICHAEL STERN, *Minority Staff Director*

SUBCOMMITTEE ON SOCIAL SECURITY AND INCOME MAINTENANCE PROGRAMS

WILLIAM L. ARMSTRONG, Colorado, *Chairman*

DAVID DURENBERGER, Minnesota
JOHN C. DANFORTH, Missouri
ROBERT J. DOLE, Kansas

DANIEL PATRICK MOYNIHAN, New York
DAVID L. BOREN, Oklahoma
RUSSELL B. LONG, Louisiana

CONTENTS

Public Witnesses

Page

Austin, Kenneth R., chairman and chief executive officer, Equitable Life Insurance Co. of Iowa accompanied by Arthur Fefferman 281

AFL–CIO, Bert Seidman, director, Department of Social Security, accompanied by Robert McGlotten, associate director, Department of Legislation 75

American Federation of State, County, and Municipal Employees, Josiah Beeman, director of political and legislative affairs 78

Bassett, Preston C., consulting actuary, National Association of Manufacturers 193

Beeman, Josiah, director of political and legislative affairs, American Federation of State, County, and Municipal Employees 78

Butler, Dr. Rebecca, Cherry Hill, N.J 47

Callas, Mike, Hagerstown, Md 48

Devecchio, Lois, Potomac, Md 47

Eichelberger, Don A., CLU, representing National Association of Life Underwriters accompanied by Robert A. Pierce 278

Equitable Life Insurance Co. of Iowa, Kenneth R. Austin, chairman and chief executive officer accompanied by Arthur Fefferman 281

Hacking, James, assistant legislative counsel for Federal legislation, National Retired Teachers Association/American Association of Retired Persons, accompanied by Peter Hughes, legislative counsel 4

Jones, Lowell M., administrator of employee benefits, Firestone Tire & Rubber Co., accompanied by Michael J. Romig, director, U.S. Chamber of Commerce 165

Keith, Hon. Hastings a former member of Congress from Massachusetts 65

Macy, John W., Jr., former chairman, U.S. Civil Service Commission 66

McKevitt, James D., director of Federal legislation, National Federation of Independent Business 197

Mitchael, Arthur, Harrisburg, Pa 50

National Association of Life Underwriters, Don A. Eichelberger, CLU, accompanied by Robert A. Pierce 278

National Association of Manufacturers, Preston C. Bassett, consulting actuary 193

National Association of Postal Supervisors, M. J. Twomey, executive vice president 80

National Federation of Independent Business, James D. McKevitt, director of Federal legislation 197

National Retired Teachers Association/American Association of Retired Persons, James Hacking, assistant legislative counsel for Federal legislation accompanied by Peter Hughes, legislative counsel 4

Oakar, Mary Rose, a U.S. Representative from Ohio 167

Re, John, staff tax administrator, United States Steel Corp. and a member of Council of State Chambers of Commerce 195

Schroeder, Patricia, a U.S. Representative from Colorado 167

Seidman, Bert, director, Department of Social Security, AFL–CIO accompanied by Robert McGlotten associate director, Department of Legislation 75

Twomey, M. J., executive vice president, National Association of Postal Supervisors 80

United Auto Workers, Dick Warden, legislative director 81

U.S. Chamber of Commerce, Lowell M. Jones, member accompanied by Michael J. Romig, director 165

United States Steel Corp., John Re, staff tax administrator 195

Warden, Dick, legislative director, United Auto Workers 81

Additional Information

	Page
Committee press release	1
Prepared statement of the National Retired Teachers Association and the American Association of Retired Teachers	12
Prepared statement of Dr. Rebecca Bates Butler	59
Prepared statement of Michael G. Callas	61
Prepared statement of Hastings Keith	73
Prepared statement of Bert Seidman	101
Prepared statement of Josiah Beeman	109
Prepared statement of Maurice J. Twomey	153
Prepared statement of Dick Warden	159
Prepared statement of Congresswoman Mary Rose Oakar from Ohio	180
Report from U.S. Chamber of Commerce	206
Prepared statement of Lowell M. Jones and Michael J. Romig	225
Prepared statement of Preston C. Bassett	240
Prepared statement of John Re	251
Prepared statement of James D. McKevitt	261
Prepared statement of Don A. Eichelberger and Robert A. Pierce	288
Prepared statement of Kenneth R. Austin	303

SOCIAL SECURITY FINANCING AND OPTIONS FOR THE FUTURE

FRIDAY, JULY 10, 1981

U.S. Senate,
Subcommittee on Social Security,
Committee on Finance,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9 a.m., in room 2221, Dirksen Senate Office Building, Hon. William L. Armstrong (chairman) presiding.

Present: Senators Dole, Armstrong, Grassley, Durenberger, Long, Moynihan, and Bradley.

[The committee press release follows:]

Press Release No. 81-148

PRESS RELEASE

FOR IMMEDIATE RELEASE

UNITED STATES SENATE
COMMITTEE ON FINANCE
Subcommittee on Social Security and
Income Maintenance Programs
2227 Dirksen Senate Office Building

FINANCE SUBCOMMITTEE ON SOCIAL SECURITY AND INCOME MAINTENANCE PROGRAMS ANNOUNCES NEW TIME FOR JULY HEARINGS

Senator Bill Armstrong, Chairman of the Subcommittee on Social Security and Income Maintenance Programs of the Senate Finance Committee, announced that the Subcommittee hearings on July 7, 1981 (see PR 81-145) on social security financing and options for the future will commence at 9:00 a.m., rather than 10:00 a.m. and will continue at 2:00 p.m. in Room 2221 of the Dirksen Senate Office Building.

The July 8 hearing has been rescheduled for Friday, July 10, at 9:00 a.m. in Room 2221 Dirksen Senate Office Building. The hearing on the afternoon of July 9 will proceed as scheduled at 2:00 p.m. in Room 6226 Dirksen Senate Office Building.

PR 81-148

Senator **Armstrong**. The committee will come to order. We have a very interesting and lengthy agenda this morning and so I think it is important that we move expeditiously.

My feeling, I would say to members of the committee, is that while, of course, it is premature to draw any conclusions from what we have been told, that it is nevertheless obvious from the testimony that has been submitted thus far that some changes in the basic social security law will be necessary. From the testimony that has been submitted by prior witnesses, it is clear that unless something is done, the social security trust fund will not be able to meet its obligations by sometime as early as late next year.

In the longer range, there is a dispute about the extent to which the system is in deficit. I hope we will be able to pin that down either in our discussion this morning or in some way because it seems to me that we have really a unique opportunity to adopt a long-term, broad-gage approach to this problem.

The underlying priority, it seems to me, is to keep faith with the people who have organized their lives on the assumption that social security benefits will be available to them on a timely manner, and in a way which is completely dependable.

At the same time, it seems to me that we must be conscious of social security's burden to taxpayers, and that is a matter I anticipate we will discuss quite a bit. In fact, overnight, I have asked the staff to prepare a chart which has blossomed over on the side of the hearing room, comparing the projected costs of social security as a percentage of payroll.

Yesterday you will recall that we looked at a chart comparing social security cash benefits as a percentage of gross national product, which is an interesting insight. In my judgment, however, it is not a real measure of the burden of social security so far as the people who are paying for it are concerned.

So, I did ask staff overnight to prepare this chart, [Indicating.] showing where the payroll tax will have to go if we just leave the program as is with no amendments, no changes, which obviously is not going to happen. A consensus, I think, is emerging for some changes. As you can tell from the chart, under the most pessimistic predictions, the payroll tax would rise sometime in the middle of the next century to 48 percent. Obviously that is not going to happen because long before it reached any such proportionate payroll, it would either bankrupt the country or there would be some kind of serious disruption in the social arrangements of our country. It is what one of the witnesses yesterday, I believe Senator Chiles, described as the intergenerational time bomb. That is an apropos term.

Under the intermediate forecast, the cost of social security as a percentage of payroll, would rise to around 27 percent.

I am advised that the 27 percent roughly corresponds to the administration's intermediate projections, while the 48 percent figure relates to the more pessimistic projections. As you can see, there is an optimistic projection—if you could so characterize it—that we might not have to go about 18 percent of payroll.

The main thing, and what I hope will be the focus of our discussion this morning, is that we are not dealing with an issue which is primarily one of facts and figures; but, one of people. Because there are already 36 million people who are planning their lives on the assumption that the social security trust fund will be preserved and that payments will be made in a timely manner. So this is a human problem rather than primarily an actuarial or economic or statistical phenomenon. At least that is the way that I approach this issue, and I anticipate that other members of the committee also feel that way.

Before I present the witnesses, let me ask Senator Grassley if he has any observations that he wishes to make at this point.

Senator **Grassley**. Mr. Chairman, I don't have any observations to make, but because of today is another day for me, like the last two have been, that I am going to be able—or that it is going to be necessary for me to be in and out of this meeting, I would like the indulgence for me to introduce, even though they don't have to be recognized at this point, two leaders in the insurance industry in the State of Iowa, who are the last two witnesses before this subcommittee. So I would like to do that at this point.

It gives me a great deal of pleasure to welcome to this subcommittee, two of Iowa's most distinguished citizens—Don Eichelberger who represents the National Association of Life Underwriters and Dr. Kenneth Austin who is here today on behalf of the American Council of Life Insurance. Dr. Eichelberger is a native of Waterloo, Iowa, and is an insurance agent for the Equitable of Iowa Co. He is past president of the Waterloo Association of Life Underwriters and the Iowa Association of Life Underwriters.

He is a recipient of virtually every accolade the insurance industry can bestow upon one of its members, including the Equitable of Iowa's Hall of Honor award.

As chairman of the National Association of Life Underwriters Federal Law and Legislation Committee, Don continues a career which includes service to his profession, to his church, and to his country.

Kenneth Austin is also a native of Iowa, is president, chief executive officer of the Equitable of Iowa Co. He has devoted himself to serving the insurance industry and has actively served in numerous charitable causes.

So for those people who are last on your program, I would like to have the committee know that they are hearing from people who believe that the total solution to the problems we face today having economic security for retirees does not rest just upon the Federal Government, but that there is a private sector, partial solution to this, and that are going to discuss that as well as give us their ideas on how the social security trust fund can be real social security for future retirees in this country.

Senator **Armstrong**. Thank you Senator Grassley.

Senator Durenberger?

Senator **Durenberger**. Good morning, Mr. Chairman.

Senator **Armstrong**. Good morning, Senator. Do you have any opening remarks? Do you have any charts to present?

Senator **Durenberger**. None. I'm just enjoying them reasonably.

Senator **Armstrong**. Well, I just asked that. Senator Moynihan will be along presently, and he has not confided to me that he will have any charts. But it wouldn't surprise me if he did.

I wouldn't be surprised when he arrives, I am going to hear a few comments on mine as well.

Members of the committee, we are very pleased to welcome this morning to begin the testimony, Mr. James Hacking, who is here to represent the National Retired Teachers Association and the American Association of Retired Persons. He is accompanied by Mr. Peter Hughes, who is legislative counsel for these groups. As I said at the outset, it is my belief that the committee must continuously focus on the impact of social security on individual people. It is my belief that the organization which we are about to hear from is the largest and most influential organization representing retired persons. In fact, it is my understanding that they represent some 13 million retired persons. So your testimony today is most welcome and we are eager to hear from you.

Mr. Hacking.

STATEMENT OF JAMES HACKING, ASSISTANT LEGISLATIVE COUNSEL FOR FEDERAL LEGISLATION, NATIONAL RETIRED TEACHERS ASSOCIATION/AMERICAN ASSOCIATION OF RETIRED PERSONS, ACCOMPANIED BY PETER HUGHES, LEGISLATIVE COUNSEL

Mr. HACKING. Thank you, Senator. I am going to defer to our legislative counsel to make the Associations' presentation.

Mr. HUGHES. Senator, as the person with seniority, having seen Mr. Hacking on the "Today Show" with you earlier this week, I decided that he shouldn't have all the glory and I would take the lead this morning.

I very much appreciate your opening comments, this is a people issue as you pointed out. We represent 13 million people who are very concerned about what is happening with the social security system. I might also say that I am glad to see our friends Mr. Durenberger and Mr. Grassley here. We have had a long association with both Senators. Olaf Kaasa, the president of the American Association of Retired Persons, who is from Minnesota, asked me to please pass along his best regards to Senator Durenberger. Mr. Kaasa serves on his advisory committee on aging issues.

With your permission, Mr. Chairman, I would like to summarize what is a rather extensive statement in order that we might have time for questions and answers. I will try to do that as quickly as possible before the red light and the bell comes on.

I would also request that the chairman allow our full statement to be made a part of the record.

Senator ARMSTRONG. Of course.

Mr. HUGHES. The worsening financial condition of the social security trust funds confirms the need to make fundamental changes in the system's benefit and financing structure.

These changes, however, must be well conceived, and should move the system toward solvency. Not only for the short term, but over the long term as well.

Simplistic, ill-considered cutbacks that are aimed solely at shoring up the system for the next 5 years will undermine not only the beneficiaries', but also current and future workers' confidence in the system.

In dealing with the immediate problem, Congress has two options: Cut benefits or add revenues.

Payroll tax increases are obviously out of the question. The resistance to any use of general revenues has been building.

But, if the use of limited amounts of general revenues on a temporary basis to meet the short-term deficit is ruled out, we fear that this Congress will end up making drastic cuts in benefits. Cuts which will fall most heavily on the most helpless and the least vocal segment of the society; namely, the retired elderly, and particularly the very old and those who are widowed.

The vast majority of these people will have no way to offset such losses. They cannot be expected to return to work, and they are already experiencing huge losses due to inflation's impact on the fixed components of their incomes.

Poverty rates among them are rising. And evidence of sharp declines in the real income situations have begun to appear. These people cannot afford substantial cuts in the basic mainstay of their income—social security.

The continuation of full cost of living protection is critical, since in many cases, this is the only means available to them for avoiding poverty. For this reason, we are vehemently opposed to any significant cutbacks in cost of living adjustments.

We ask this committee, and the Congress, to consider the following facts:

In 1979, despite full social security cost of living increases, the elderly poverty rate rose dramatically from 13.9 to 15.1 percent; while the poverty rate for the nonelderly remained virtually unchanged at around 11 percent.

So many of the elderly are concentrated just above the poverty threshold, that in 1979 a drop in their income of less than $15 to $20 a week would have caused the elderly poverty rate to jump from the 15 percent at that time to over 25 percent.

Rather than slashing benefits for a group in society that can obviously least afford it, we believe it would be more reasonable to stabilize the system with a temporary infusion of general revenues only as needed to maintain combined trust fund levels at a 20- to 25-percent level.

If the economy performs reasonably well, this additional revenue could be relatively small. If the economy does not, then to accommodate the additional revenue needed without enlarging the deficit, other Government expenditures may have to be reduced.

The size of the tax cut may have to be smaller.

Or nonpayroll tax sources, like the windfall profit tax might have to be utilized.

As this is done, fundamental changes must begin to be phased in that will reshape the system so that it will be able to accommodate the system's severe long-term deficit. Such changes should encourage older workers who are willing and able to increase their work effort and also to make the system more equitable in its treatment of individual workers and more adequate and reliable for future retirees.

In order to promote work effort, particularly on the part of older persons, we are not suggesting, and in fact are opposed to an increase in the social security full benefit age beyond 65.

Rather than raise the age for full benefits, the system must be changed to encourage work effort on the part of the elderly through the elimination of earnings limitation, the provision of actuarially increased benefits for those persons who delay filing for benefits beyond the age of 65.

Also, the early retirement penalty might be increased somewhat to reverse the early retirement age trend for those who currently opt for early retirement as a matter of choice.

Elements in the present system benefit structure which operate to encourage early retirement and discourage continued work effort must be changed. But the age 68 proposal is not the answer.

In order to make social security's programs more equitable and adequate, they must be gradually restructured. First the payroll tax should be used mainly to finance the cost of benefits paid to workers; and second, the amount of an individual worker's benefit should be strictly related to that worker's earnings record and payroll tax contributions.

In this manner, the pension and individual equity elements of the social security system, both in retirement and disability programs, would be emphasized and made more clear to workers and beneficiaries.

Those elements in social security that are now financed by payroll taxes and are welfare or social adequacy in nature should be gradually shifted to separate benefit structures and financed from general revenues.

These structures would supplement the basic earnings-related benefit and guarantee at least poverty-level income.

This type of restructuring will provide today's young workers with the assurance that they will get a benefit from social security that will reflect what they earned and payed for. And will represent a good buy in terms of their expected rate of return on investment. In addition, they will have the assurance that in later years, they will have good prospects for achieving income adequacy and avoiding poverty. This is an assurance that the system, as presently structured, does not and cannot provide.

Thank you Mr. Chairman.

Senator **ARMSTRONG**. Thank you very much.

Senator Durenberger?

Senator **DURENBERGER**. Thank you.

I would like to start by complimenting Mr. Hacking and Mr. Hughes on their presentation today and also their presentation before the Select Committee on Aging.

During the course of this week, I have been asking a variety of questions that relate to the noncash commitment in social security—principally hospitalization. In just trying to explore with people who care about the needs of the persons on fixed incomes where we might be heading in this country in terms of seeing that the needs of those people are satisfied.

Looking at our current commitment to those who participate in the social security program, and a commitment I guess that is extended to those who don't, a lot of people in public employment, we seem to have structured over the last 15 years a combination cash income security commitment and this commitment to health care as one of those hard to determine costs, particularly for the aging part of our population.

Particularly with regard to those who say we ought to go temporarily into general revenue, as Mr. Hughes indicated here this morning. Or that we ought to interborrow between funds, I would like to specifically address the issue of the use of the payroll tax as a funding mechanism for health care costs in this country.

The current health care costs are somewhere in the neighborhood of $240 to $250 billion. And, of that amount, approximately

$100 billion is for a variety of the health care expenses of senior citizens.

Of that amount, about 30 percent is covered under the—funded by the payroll tax, the party hospital coverage.

My concern is whether in either the short, or the long term it makes sense to use the payroll tax as a means of financing health care costs. As you know, I come at this from two perspectives. One is the security of the income security part of our commitment to people; and the other is what our national policies do to either foster or restrain the cost of health care in this country.

In my own mind, I am trying to figure out whether or not it makes sense to look at alternative funding mechanisms for hospital and other health care costs and is there some special value in retaining the payroll tax as a means of financing a portion of those costs.

Mr. HUGHES. Senator, let me respond to your last question first, if I may.

I think there is some special value in retaining the payroll tax because it makes the program an entitlement program. It is something that people have paid for over their working lifetime.

As you know, our associations are adamantly opposed to the proposition that you can deal with the social security short-term or long-term financing problems by financing 50 percent of HI out of general revenues.

If that were being done this year, you would be talking about a $15 billion infusion of general revenues into the HI program.

We do not like this approach, we favor direct infusion—of general revenues—on a limited and temporary basis into the cash benefit side. It is less money, it is temporary and it goes up and down with the economic situation in the country.

You also, I know, are aware that our association strongly supported the Carter administration's attempts to get some kind of handle on hospital costs. While we have experienced a 10-, 11-, 12-, 13-percent general rate of inflation, the rate of inflation in hospital costs has been 15, and 16, and 17, and 18 percent.

So, the point I really want to make is that to tie the financing of social security to an area of the economy which has experienced one of the highest rates of inflation is absolutely ludicrous. We are absolutely totally opposed to that.

The second point, again, in regard to your question is yes; I think that some contributory aspect of the program is desirable because it does make it a matter of right. It keeps it out of the welfare realm.

Senator DURENBERGER. Thank you.

Senator ARMSTRONG. Thank you, Senator Durenberger.

Senator Dole?

Senator DOLE. Thank you, Mr. Chairman.

I know there are a number of witnesses, so I will just briefly ask a question or two.

First, I appreciate your appearance and your testimony. It has been a pleasure to work with you in the past on the earnings limitation and other things that we think are steps in the right direction.

The question as you so well state, is how to solve the problem that most people believe exists unless we take a look, not at slashing current benefits, but at making some changes down the road. You indicate that general revenues might be necessary in the short term, but that means a tax increase, of course. How can we say no payroll tax increases but take it from general funds and let everyone have a little tax increase. I don't see the logic in that.

Mr. HUGHES. Senator, with all due respect, I would ask the question how can the self-same committees, both the Senate and the House, approve a tax expenditure of $5 billion to bail out the savings and loan institutions and deny the same logic to bail out a system which affects 35 million people in this country?

Senator DOLE. That hasn't been resolved quite yet.

Mr. HUGHES. We hope that it will be resolved to our benefit, not to the benefit of the——

Senator DOLE. If you will give us a little help, we might be able to modify that.

Mr. HUGHES. We are trying to, sir.

Senator DOLE. At least so it benefits your membership. The way it is drafted now, I don't think anybody in your group can participate.

Mr. HUGHES. No, sir, I don't think it will benefit our membership. I don't think it will benefit older people in this country. I don't think it will benefit small savers in this country.

Senator DOLE. We are looking at ways to make those things happen. And, of course, S. & L.'s are important to a lot of people that you represent.

What you would do, I believe, is simply encourage people to work longer through the elimination of earnings limitation provision rather than to even phase in any later retirement. Is that correct?

Mr. HUGHES. No, sir, I don't think so. I think, No. 1, let me say that we certainly appreciate your support for doing away with the earnings limitation. That is probably the single most important factor in the decision to quit for those older workers who are willing and able to continue to work.

Senator DOLE. What percent of older workers would stay in employment?

Mr. HUGHES. Mr. Hacking might have some figures on that, I am not sure what the percentage is; but we do know that studies have shown that of those older workers who continue in the labor force, the majority of them work up to whatever the current earnings limitation is and then they drop out and then they come back in the following year.

One thing that we really like about the administration proposal is that it advances a philosophy of work incentive. To do away with the disincentives. There was, on their part, a commitment to the age 65 retirement age, which we also appreciate. And we also support.

We need to encourage those people who are willing and able to stay in the work force, to keep contributing, to not drain down on the system. We feel in that regard, the administration did not go quite far enough. Those workers who elect to stay in the work force beyond age 65 and not draw social security benefits, ought to receive an actuarially increased benefit. It is scheduled to go to 3 percent a year it should be somewhere around 9 percent.

Senator DOLE. A number of us supported that effort a couple of years ago in the Senate.

Mr. HUGHES. Yes, sir, you have.

Senator DOLE. Led by Senator Goldwater. In fact I have asked him if he would like to testify. I think he is going to file a statement in support of your efforts.

Well, my time is about expired. I appreciate the testimony you both have submitted.

Mr. HUGHES. Thank you.

Senator ARMSTRONG. Mr. Hughes, I want to also explore the question that Senator Dole was discussing.

I share your enthusiasm in taking off the earnings limit. But I would like to ask how you respond to the charge which was made yesterday that taking off the earnings limitation is unfair because it benefits primarily higher income retired persons. In fact, that was very bitterly contested during yesterday's discussion. What do you say? How do you answer that?

Mr. HUGHES. I think that is the oldest piece of boiler plate in this town, and it is rusty.

There is nothing in human nature that is going to make a doctor, or a lawyer, or a U.S. Senator decide to retire because he wants to get his social security benefit. And, this farce about how this is only going to benefit higher paid executives and professionals has been perpetuated for years, and years, and years.

If you look at the statistics, most of the people who continue to work beyond the age of 65 quit when they reach the earnings limitation. Now are those lawyers? Are those doctors? Are these dentists? Are these engineers or corporate presidents?

I don't think the earnings limitation has anything to do with the decision of a higher paid worker to retire. It does have something to do with the decision of a low-paid, low-income older person to quit when they reach the earnings limitation.

Senator ARMSTRONG. Could I refer to page 35 of your statement? You argue—and I note by the way with satisfaction and approval that your statement emphasizes a long-term approach to the problem—that you reject the idea that we ought to just primarily deal with it in the short run, and that you are really looking ahead 20, 30, 40 years and trying to make provision for that eventuality.

One element of your proposed restructuring is a gradual phasing out of the weighted benefit formula and replacing it with a flat formula. I want to be sure that I understand what you are getting at. You are simply saying that the computation of retirement income under social security should be made a percentage of the covered employment, doing away in effect with the bend points altogether.

Mr. HACKING. Yes, that's correct, Senator.

Senator ARMSTRONG. Is that subject to the same kind of objection that we were just discussing a moment ago? In other words, does that benefit primarily high income retirees?

Mr. HUGHES. I don't really believe so. I think that if you look back the weighted benefit was put in for one primary reason and that was to adequately provide for those people who had limited work experience. People who were in and out of the labor force or who worked the majority of their lives in low income jobs. It was useful at that time.

Currently your contributions are not reflected in your benefits when you are at the lower end of the system and it is benefiting some people for whom it was never intended. The famous double dipper.

We have other programs now in place to take care of that minimum income provision and we feel that this is no longer necessary nor desirable. It might be necessary if it is not picked up in the famous administration safety net.

But is is not desirable in terms of the social security system and equity for all workers.

Mr. HACKING. One of the things, Senator, that will result by, in effect, beginning to sort out the functions of the social security programs is that, as we go about the process of doing this and phasing in these kinds of changes, we would begin to phase in a direct relationship between future benefits awarded to future older people relative to what they earned, contributed and paid for. This relationship is something that has been lost in the programs as currently structured. I think Hayworth Robinson's testimony yesterday illustrated this point very well.

If we don't begin to restore the element of individual equity that has been gradually lost over time as the programs have evolved, then we can expect that today's younger workers are going to find that social security, over a time, is going to be a very poor buy for them and they are going to lose their support for the system.

This is a very major matter to us, and that is why we have been strong advocates for fundamental change in social security. We must begin to make the kind of changes that will indeed begin to reorganize the social security program cluster and sort out these functions.

Senator ARMSTRONG. That's the intergenerational time bomb argument again.

Mr. HACKING. Precisely.

Mr. HUGHES Well, if I may, Senator, I would like to comment on that.

We have discussed earlier in private some of the studies and surveys that we have run. There is great support for the system among all age groups. A recent survey that we did—ages 25 and over—showed among the 25- to 55-year-olds, 69 percent would rather see more revenue infused into the system than have cuts in benefits; 71 percent of those 55 and older said the same thing. That's pretty close. I don't think there is any intergenerational gap. Younger people such as myself, don't like to pay $2,000 a year in payroll taxes, and I am sure many employers like it less.

But if it weren't for social security, I probably would be paying much more than that to support my parents who are both 76 years of age. It's a good buy for younger people. We do have problems, we need to straighten some things out.

I might add too that one of our part-time employees who just had his 69th birthday yesterday, came up with what he calls the Chicken Little Syndrome.

Unfortunately, I think that Secretary Schweiker and Mr. Myers are the epitome of the Chicken Little Syndrome. They are scaring the hell out of the old people in this country by running around saying that the system is teetering on the edge of bankruptcy.

The system can only go bankrupt if the Congress and the U.S. Government decides to break the promise to the people that the system is going to be there when they need it. I wish they would stop doing that.

On the other hand, we are not running around like some former social security commissioners saying there are no problems, you don't need to do anything.

We are somewhere in the middle. We think there are problems. We think some changes are necessary to address these problems. We think these changes should impact least on those people who can least afford to be adversely affected.

Senator ARMSTRONG. Mr. Hughes, you make a very good point. This is not the moment to debate the rhetoric that may have been used by people who describe the system—either those who say that everything is OK and we don't need to do anything or those who feel that the system may be teetering on the brink of bankruptcy. It is obvious that the system is on the brink of insolvency which, of course, is a bit different.

In general, I share your feeling that the system is backed ultimately by credibility of the Congress of the United States. But it may well be that one of the reasons there is so much concern among retirees is that the level of competence in the Congress is not as high as it ought to be.

Mr. HUGHES. I won't comment on that, Senator.

Senator ARMSTRONG. The thing I want to say is this, this is a great country. It's a resourceful country. It's a country of enormous economic muscle and creativity and so on. But I don't think we ought to assume, even for a moment, that everything is in the control of the Congress.

Disasters do occur. One reason why I am attracted to the general thrust of your testimony is that you are saying: let's make a plan to be sure that a crisis doesn't get out of hand. People said that the *Titanic* couldn't sink, they said that the stock market couldn't crash, and they said that the *Hindenburg* wouldn't crash and burn. I don't know all the disasters that occurred that people said were impossible. But I do know the very worst of which have been the disasters economists said could never occur.

I have sat here more than once and listened to economists say we couldn't have rising inflation and rising unemployment.

In fact, if you would make a catalog of all the things which the experts said couldn't happen to our economy which have subsequently happened, there is substantial reason for concern. Whether you want to characterize social security future as a crisis or as a bankruptcy is a question only of selection. The fact of the matter is that social security is going broke. I would like to ask one more question. You mentioned that there are those who take a view that is somewhat more optimistic than that which you have expressed. I take it that you are referring to the SOS Coalition. My understanding was that your organizations, that is the AARP and the NRTA, were a part of the SOS Coalition. I take it that that is not the case any longer?

Mr. Hughes. We are part of the SOS Coalition but I think, as most Members of Congress realize, we feel that we are our own best spokesman. We take pride in the fact that we are taking a reasonable and responsible approach to the problems of the system and the current economic and political realities. While we are part of the coalition, quite frankly we are at arm's length. We will be part of the coalition when and where we agree, and we are finding over time that we are agreeing less, and less.

I might just add, Senator, that we are very cognizant of your concern and the concern of your colleagues on this committee for the well being of system and for doing what is least harmful to those persons who can least afford to be hurt in trying to deal with the systems problems.

We also appreciate the fact that you gentlemen recognize the economic and political realities of what's going on. We want to thank you for that.

I would hate to see this Congress do the same thing that was done in 1977 when it was said we are saving the social security for the next 75 years, and I think that anybody who really believed that didn't realize what was going on in this country.

Senator Armstrong. Thank you.

Thank you gentlemen.

Senator Moynihan, did you have anything?

Senator Moynihan. I would just like to ask if you would prefer that we not favor saving social security?

Mr. Hughes. No, I would prefer that you do and not just say so.

Senator Moynihan. That must be a reversal.

I must mildly protest. The 1977 effort was a serious and responsible one; and, I will be much impressed if this committee in its present form does more or does better. Thank you.

Senator Dole. Well, might I just add there is—coalitions are not bad. I mean, we like coalition, particularly on the House side. [Laughter.]

So, I don't want to say that all coalitions are bad.

Mr. Hughes. I don't believe that I said that coalitions were bad, Senator Dole.

Senator Dole. No. But there are disagreements even among them.

Mr. Hughes. Yes, sir.

Senator Armstrong. Thank you, gentlemen. We very much appreciate your testimony.

Mr. Hughes. Thank you, Senator Armstrong.

[Statement follows:]

STATEMENT OF THE NATIONAL RETIRED TEACHERS ASSOCIATION AND THE AMERICAN ASSOCIATION OF RETIRED TEACHERS

INTRODUCTION AND SUMMARY COMMENTS

The deteriorating financial condition of all three social security trust funds as recently reported by the Social Security Trustees confirms the need for for Congress to consider making fundamental, far-reaching changes in the system's benefit and financing structures. These changes, however, must be well-conceived and move the system toward solvency over the long-term as well as over the short-term. Simplistic, ill-considered cutbacks that are aimed solely at shoring up the system for the next five years will undermine not only beneficiaries', but workers' confidence in the system.

- Both the short and long-term deficits faced by social security are serious and could be even larger than currently projected. Adverse economic conditions have repeatedly caused both the OASI and DI trust funds to run unexpectedly large deficits - a $3.8 billion shortfall in 1980 alone. The volatility and unpredictable nature of the economy has made the payroll tax structure extremely unreliable and, for the next five years will make it nearly impossible to predict accurately what the system's short-term financing needs will be.

Congress has two options: it can either cut benefits to meet the deficit or it can raise revenue coming into the system. Payroll tax increases seem to be out of the question and resistance to any use of general revenues has been building. We would like to warn Congress that if it rules out using general revenues and therefore forces itself to rely exclusively on cutting benefits to meet what could be a large short-term deficit, it will end up concentrating the cuts on an economically vulnerable group who are the most helpless and least vocal. The elderly particularly the very old and those who are widowed, have few options. The vast majority of them cannot be expected to return to work. And they are already experiencing huge losses due to inflation's erosive effect on their fixed income sources. Poverty rates among them are rising and evidence* of sharp declines in their real income situation have begun to appear. As a group, they are least able to afford substantial cuts in the basic mainstay of their income -- social security. The continuation of full cost-of-living protection is particularly critical since, in many cases, this is the only income that stands between them and poverty. For this reason, we must vehemently oppose any cutbacks in this vital benefit area.

The income situation of the elderly is precarious and has already shown signs of deterioration. Given this adverse scenario, social security benefit cuts of any substantial magnitude will dissipate whatever shred of income security they have left and will cause increasing numbers of them to be pushed into the lower reaches of the income distribution and, in many instances, even below the poverty threshold.

---

*Barnes, Roberta and Zedlewski, Sheila. The Impact of Inflation on the Income and Expenditures of Elderly Families. The Urban Institute, April 1981.

Consider these startling facts and statistics that have brought us to vehemently oppose substantial short-term social security cuts:

* In 1979, despite full social security cost-of-living increases, the elderly poverty rate rose dramatically -- from 13.9% to 15.1% (the first large increase since the Census Bureau began collecting such statistics), while the poverty rate for the non-elderly remained unchanged at 11.1%.

* So many of the elderly are concentrated just above the poverty threshold that, in 1979, a drop in their income of less than $15 to $20 a week would have caused the elderly poverty rate to escalate from 15% to over 25%.

* The elderly are unquestionably a low-income group especially compared to the non-elderly -- in 1979, 31% of the elderly had incomes below $5,000 and 62%, below $10,000, while only 9% of the non-elderly had incomes below $5,000 and 21% below $10,000.

Rather than slashing benefits for a group in society that can obviously least afford it, we believe that a more reasonable and equitable response to social security's short-term problem would be to stabilize the system with temporary infusions of general revenues, as needed to maintain combined trust fund levels at a 20-25% level. Raising revenue for social security could entail having to reduce other government expenditures, limit the size of the tax cut, or increase revenues from non-payroll tax sources -- as, for example, a temporary surtax on the income tax. The point here is to avoid frustrating the effort to balance the budget, one of the things that must be done to bring down inflation.

As this is done, Congress should move to phase-in reforms in social security that may entail some benefit reductions, but that would reshape the system so that it would be able to accommodate the system's severe long-term deficit. Such reforms must first, encourage workers -- particularly older workers -- to increase their work effort and second, make the system more equitable in its treatment of individual workers and more adequate for retirees.

In order to promote work effort, particularly on the part of older persons, we are not suggesting an increase in the social security full benefit age to 68. Rather than raise the normal retirement age to 68, the social security system benefit structure must be changed to encourage work effort on the part of the elderly through elimination of the earnings limitation and the provision of actuarially increased benefits for persons who delay filing for benefits. In addition, we agree that the early retirement penalty should be increased somewhat in order to reverse the dangerous trend toward early retirement. Certain elements in the present system's benefit structure operate to encourage early retirement and, until those elements are changed, any increase in the normal retirement will not yield the results which proponents of the age 68 proposal expect. Beyond this consideration, the age 68 proposal is an obvious benefit cut for younger workers who are now being asked to bear higher payroll tax burdens. Such a reform could begin to undermine younger workers' already precarious support for the system.

With respect to our second long-term objective of making social security more equitable and adequate, we recommend that social security be gradually restructured so that first, the payroll tax is used mainly to finance the cost of benefits to workers and second, the amount of an individual worker's benefit be made more strictly related to that worker's prior earnings/payroll tax contributions. In this manner, the pension and individual equity elements of social security -- both in the retirement and disability portion of the program -- would be emphasized and made more clear to workers and retirees.

Those elements of the present social security system which are now financed by the payroll tax and which are welfare or social adequacy in nature should be gradually shifted on to separate benefit structures and financed from general revenues. These structures would supplement the basic earnings-related benefit and guarantee at least poverty-level income.

This type of restructuring will provide younger workers with the assurance that they will get a benefit from social security that reflects what they earned and paid for and represents a "good buy" in terms of their expected rate of return on investments. In addition, they would have the assurance that, in their later years, they would have good prospects for achieving income adequacy and avoiding poverty. This is an assurance that the system, as presently structured, cannot provide.

Having outlined the basic framework for how our Associations believe Congress should resolve the system's short and long range problems, I would like to comment on and propose alternatives to recommendations recently made by the Administration as well as the House Social Security Subcommittee.

CUTBACKS IN COST OF LIVING PROTECTION

Social security's cost-of-living adjustment mechanism has recently become a frequent target of Congressional criticism. Debate on this issue has been spurred by allegations that the Consumer Price Index (CPI) overcompensates the elderly for inflation and by assertions that it is unfair that social security benefits increase more rapidly than the average rise in workers' wages.

Cutbacks in cost-of-living protection would obviously yield large short-term savings for social security as well as large real income losses for retirees and a resurgence of high poverty rates among them. For these reasons, our Associations will work to protect this area of the benefit structure. Even the Administration realized the importance of cost-of-living adjustments and therefore recommended a very limited cutback in cost-of-living protection even though substantial congressional support exists for more substantive cuts.

Indexing Flaws. Social security's cost-of-living adjustment mechanism is flawed in two ways: first, benefit increases are provided long after inflation has taken its toll on the purchasing power of benefits; and second, the standard used in making adjustments, the CPI itself, does not always accurately reflect the true impact that inflation has on elderly budgets.

With respect to the first point, a January 1981 OMB study indicated that since 1975, beneficiaries of these programs have experienced a 3.4% decline in real benefit levels due to the lengthy lag time in adjusting benefits. It should be readily apparent from this analysis that proposals to delay payment of cost-of-living increases another 3 months (from July to October) would exacerbate this loss in benefit purchasing power and make the current indexing mechanism far more inadequate and flawed than it already is.

As for the second point, some economists have argued that the CPI tends to overstate inflation for the elderly because of its faulty treatment of housing costs. Detailed studies of this issue, however, do not confirm this contention. An exhaustive study conducted for our Associations by economist, Dr. Thomas Borzilleri, investigated the accuracy of the CPI and found no consistent pattern of over- or undercompensation for inflation. A copy of this statement is made available for the record of this hearing.

Based on data collected from the 1972-73 Consumer Expenditure Survey, the Borzilleri study constructed a special CPI or social security market basket that reflected the elderly's special expenditure patterns. In constructing a special social security market basket, the study utilized the most conservative possible definition of homeownership costs. It was assumed that no one in the social security population ever purchased a new home or ever bore higher mortgage interest costs. This definition would be sure to correct any alleged overestimate of inflation for the elderly as a result of rises in the cost of home mortgage interest rates.

Given this definition of homeowner shelter costs, the major findings of the study were as follows:

First, differences between the rate of inflation produced by the general CPI and the rate of inflation produced by the social security market basket were found to be extremely small.

Over the entire period of automatic indexing, social security benefits increased at an average annual rate of 8.6 percent a year while the social security market basket increased at an average rate of 8.0 percent a year. Thus, it appears that no major overcompensation or undercompensation has occurred.

Second, expenditure patterns for the retired are radically different from those reflected by the CPI. Food, fuel and utilities, and medical care play a much more important role in the market basket of the retired. This greater importance, coupled with the higher inflation rates in these three categories in the 1970's, offset the major differences in shelter costs between these two inflation measures.

The major differences in expenditure patterns have obvious implications for future benefit increases and for the method of indexing utilized by the social security program. Whether or not the CPI will over- or undercompensate social security recipients in the future depends upon price increases for home and mortgage interest costs relative to price increases for food, fuel and medical care.

Given the importance of cost-of-living protection for retirees, the high cost involved in providing such protection and the major differences in the elderly's expenditure patterns, the necessity for developing and utilizing a separate and accurate CPI to adjust social security benefits is obvious.

Comments on Cutback Proposals. Our Associations urge Congress to reject proposals that would alter the construction of the CPI strictly for the purpose of curbing the rate of increase it registers. Some analysts have endorsed the use of a rental-equivalent index, recently developed by BLS, because it would supposedly correct the CPI's flawed treatment of homeownership costs. The Borzilleri study clearly indicates that there are several flaws that need to be corrected. From the point of view of the elderly, for every overstatement of their costs in the general CPI, there is at least one understatement in another expenditure category.

Another prominent proposal to alter indexing would cap cost-of-living increases at either the average rise in wages or the average rise in prices, whichever is lower. This "wage cap" as well as any other capping proposal (such as 70% or 80% of the full CPI) would result in a severe downward ratcheting of real benefit levels particularly if imposed over a period of years.

Some proponents of the wage cap proposal seem to be advocating it on the grounds of equity -- in other words, it is inequitable to allow the incomes of retirees to rise more rapidly than the income or wages of workers who must support government programs through taxes.

First, it must be pointed out that wages usually represented the bulk of workers' incomes. Therefore, any wage increase received tends to protect most of a worker's income. In contrast, social security does not represent the elderly's total income.

In fact, social security cost-of-living adjustments maintain the real value of less than half of most retirees' income.

Second, it must be pointed out that wage increases have historically exceeded price increases and this trend is expected to resume within two years. Unless Congress is willing to adjust benefits according to the rise in wages on a permanent basis even when wages begin to outpace prices in the future, then wage indexing cannot be sold on the grounds of equity. Beneficiaries will feel -- and rightfully so -- that they will always be getting the "short end of the stick."

Workers have reasonable expectations over their future working lives of making up any real income loss they are currently suffering as a result of high inflation. Retirees, because they are not wage-earners and have many fixed components to their income, have no expectations for recouping the inflation losses they have already incurred and will continue to incur as long as inflation is with us.

SHORT-TERM GENERAL REVENUE FINANCING

A great deal of uncertainty exists regarding the size of the short-term deficit and exactly how much additional funds will be needed to stabilize social security over the next five years. Utilizing "worst-case" economic assumptions (developed by DRI), the combined OASDHI trust fund will need an additional $97.8 billion by the end of fiscal 1985 to maintain a combined trust fund balance of 25% of outgo. Utilizing the Carter budget assumptions, $66.5 billion will be necessary for a 25% balance; the CBO estimates $56.7 billion; and under the Administration's "optimistic" economic scenario, $20.7 billion would be needed to maintain a 25% balance.

Over $20 billion in social security savings over the next five years are virtually assured under both House and Senate versions of the 1982 budget reconciliation legislation. Rather than substantially reducing benefits any further, Congress should consider utilizing, on an emergency basis, limited and temporary amounts of general revenue to protect the system from both high inflation and high unemployment. We have suggested that the additional general revenues be triggered when combined trust fund levels dip below the 20 to 25% range.

To those who have been adamantly opposed to use of general revenue financing for the system out of concern that this could lead to unrestricted benefit expansion, we would point out that our proposal is one of the most conservative and restricted in design. It is designed strictly to insulate the system from adverse economic conditions and would be used only as selected benefit reductions are gradually phased-in. Once adverse economic conditions subside and savings from benefit reductions begin to accrue, then this mechanism would be automatically phased-out. Indeed, if the economy performs in a moderately favorable manner, this general revenue device may not be triggered at all.

Regarding where the general revenues which we propose to use for social security purposes would come from, we would suggest the following potential sources: (1) increased and non-earmarked revenue derived from existing or new taxes; (2) increased revenue flowing from inflation-induced growth in federal revenues ("bracket creep"); (3) deficit financing during periods of recession; (4) the shifting of expenditure priorities within the context of the federal budget process; and (5) the fiscal dividend that real economic growth will yield when it resumes.

To the extent that general revenues are needed in any year, the choice of source(s) for those funds should be made through the Congressional budget process in the light of the needs of the economy at that time. We hasten to add that since our Associations want the federal budget brought into balance over the business cycle, in coming years, no single source for the general revenues needed should be relied upon year after year.

In contrast to the more restricted nature of our proposal, some policymakers are recommending either partial or full financing of the HI program out of general revenues (with an accompanying shift of the part of the HI tax rate to OASDI). We believe it is inappropriate to consider funding HI out of general revenues as a response to the short-term financing dilemma. This proposal would make a major change in the social security system and therefore necessitates more careful deliberation and future planning.

The first major drawback of the proposal relates to its cost. Financing half of the HI out of the general revenues would necessitate a large ($14 billion) expansion of the federal budget and this amount can be expected to grow rapidly in future years since uncontrolled hospital costs will continue to rise in excess of the overall inflation rate.

More importantly, however, shifting payroll taxes from HI to OASDI does not respond to the specific cause of the short-term problem and therefore would not really provide the kind of automatic protection for the cash benefit programs that they need; it merely provides more payroll taxes in the short-term with absolutely no assurance that future economic downturns will not again upset its financial balance. Over the longer-term, the general revenue for HI proposal may end up doing more harm than good. Severing the payroll tax contribution/entitlement concept of the program, coupled with the large, on-budget costs of this proposal, could invite a means-test of program benefits as well as preclude enactment of some long needed reforms in Medicare.

EARLY RETIREMENT BENEFIT CUT

The Administration has proposed an immediate reduction in early retirement benefit levels amounting to nearly $20 billion in near-term savings. Although our Associations believe it makes sense to begin to reverse the early retirement trend by increasing the early retirement penalty, we must oppose this recommendation because the cut is too abrupt and more punitive than what is necessary to discourage early retirement. Millions of older workers approaching age 62 and planning on retirement would find their own benefits and their spouses' benefits slashed by over one-third with no time to make other financial arrangements. This benefit reduction, because it would be permanent and carried throughout older persons' retirement lives, is likely to swell the poverty rolls and create a new class of impoverished older persons. Such a large benefit cut would also play havoc with workers' retirement financing plans since many of them are locked into early retirement decisions by collective bargaining agreements or similar contracts.

Such a large early retirement penalty would be particularly harsh for older workers who lose their jobs and have no employment prospects or who are unable to keep working due to poor health. Surveys indicate that more than half of workers who involuntarily retire cite poor health as the reason for retirement and these retirees tend to be a low-income group.

Maintaining age 65 as the full benefit retirement age and avoiding an elevation of that age to 68 are important legislative objectives for the Associations. Therefore, we would support some reduction in early retirement benefit levels (from the current 80% to 70% of the full benefit amount) in order to encourage later retirement and help deal with the system's long- and short-term solvency. However, such a reduction would have to be phased-in very gradually over a period of at least five years and accompanied by other work incentives discussed later in this statement.

In addition, to ensure that chronically ill and involuntarily unemployed older workers are not unduly harmed by such a proposal, the Disability Insurance and Supplemental Security Income programs must be made more accessible to these older workers. For chronically disabled or unemployed and discouraged older workers who would continue to have no other option but to elect early retirement, our Associations would want the tests for disability under the DI program liberalized and would want the Federal Government to guarantee at least poverty-level income through the SSI program by lowering that program's eligibility age to 62 and by increasing the SSI payment standard to the poverty threshold.

Considerable discussion has focused on the proposal to raise the full benefit age to 68. This proposal appears to provide a simple, straightforward response to the adverse demographic and employment trends facing social security. However, in our opinion, the age 68 proposal would be the wrong policy option to exercise at this time. Not only would this proposal substantially decrease benefits for persons, between the ages of 65 and 68, who may be physically unable to continue working, but it would also represent a highly visible benefit cut and reduction in the expected rate of return on contributions for future retirees. This latter problem could undermine younger workers' already precarious support for the system.

Instead of raising the retirement age, more positive, incentive-type changes (coupled with a dampening of early retirement benefits) could be made in the social security system to achieve the same goal in a more voluntary manner. These changes could obviate the need for raising the retirement age since, in our opinion, they would yield the same desired result of fostering increased elderly labor force participation, increased reliance on wage income by the elderly, and the election of later retirement. To achieve these results in a voluntary manner, however, strong work incentives must be built into the social security and related program benefit structures, and barriers and work discentives which currently exist must be removed.

WORK INCENTIVE STRATEGY/EARNINGS LIMIT PHASE-OUT

The Associations strongly support elimination of the earnings limit for persons age 65+. It has acted as the major work discentive for the elderly and its elimination must be a key element of any attempt to stabilize social security financing through a work incentive strategy.

We understand that concern exists about the "cost" of such a reform and therefore support the Administration's proposal to phase-out the limit over a three-year period, however, we would point out that having a factor in social security that causes people to limit their work effort imposes a significant "cost" on society. We are convinced that the economic "cost" in terms of lost production and lost tax receipts that results from having the earnings limitation is greater than the "cost" of the additional social security outlays that repeal would entail.

An important article on the subject of cost was published in the September 1979 Social Security Bulletin. It is entitled, "Tax Impact for Elimination of the Retirement Test," and is authored by Josephine G. Gordon and Robert N. Schoeplein of the Office of Research and Statistics, SSA. This study concludes that elimination of the retirement test for workers age

65-69 would generate an additional $678.6 million in payroll taxes and an extra $997.8 million in federal individual income taxes. This additional revenue, when combined ($1.656 billion), would offset 79% of the $2.1 billion SSA has estimated it would cost to repeal the test. In addition, it has been estimated by SSA that it costs $68 million per year to administer the test due to the complicated forms and periodic reporting that it necessitates.

Some analysts argue that higher income persons would exclusively reap the benefits of eliminating the earnings limit. These analyses ignore the fact that over half of workers age 65+ hold their earnings below the earnings limit and they would also benefit from repeal of the limit. Their benefit would be in the form of the higher wages which they could earn, not in the form of higher social security benefits. SSA statistics reflected in the following table indicate that in 1977, 51% of male workers age 65-71 kept their earnings below $3,000 (the earnings limit in effect at that time).

TABLE 1. Number & percentage distribution of workers with taxable earnings, by amount of earnings and sex, 1977.

AMOUNT OF EARNINGS	MEN 65-71	WOMEN 65-71
Total Number	1,461,000	897,000
Total Percent	100	100
Less than $3,000	51%	63%
$3,000 - 6,999	18%	20%
$7,000 -14,999	17%	14%
$15,000 or more	14%	3%

Source: Continuous Work History Sample, SSA
Office of Research & Statistics, 1977

In addition, surveys show that persons with low retirement incomes want to work more than those with higher incomes. A 1974 Louis Harris survey indicated that 43% of persons age 65+ with incomes less than $3,000 would like to work compared to 31% of the retired population as a whole.

Given the present high rate of inflation and its extremely adverse impact on the present income situation of the elderly, it is important to eliminate the earnings test without delay. Since any significant social security benefit improvements in the near future are unlikely, wage income offers older persons practically the only means of preventing an inflation-induced deterioration of their living standards.

In developing an older worker employment strategy, strong work incentives must be added to the social security system benefit structure. They are needed to counter the strong deterrents which exist in the present system, such as inadequate additional benefits for workers who delay their retirement date past age 65. Therefore, we recommend that the delayed retirement credit be substantially increased--at least to the actuarial level of 8 to 10%. Under present law, individuals who elect not to receive social security benefits because they continue working beyond age 65 are entitled to a 3% bonus (beginning in 1982) for each full year of delay between age 65 and 72. This 3% credit, however, does not provide sufficient encouragement for individuals to work beyond age 65 and is not proportionate to the reduction in benefits imposed on retirement prior to age 65.

We believe a substantial increase in the credit would financially benefit the system. SSA actuarial estimates indicate that there is no additional cost to providing an actuarially-based delayed retirement credit, if this is done at the same time that the earnings test is abolished. If just the credit is raised, then SSA estimates a long-range cost of 0.25% of taxable payroll to raise the credit to 7%. As with the earnings limit, these cost estimates overlook the strong work incentive which a larger credit would provide to older workers and therefore ignore the increased tax revenue that this liberalization would generate for the system (as well as government in general). If the credit were high enough to provide an extremely strong incentive to keep working, then it would have the potential to actually decrease social security outlays.

To complement this strategy under social security, other changes are needed. All mandatory retirement practices must be prohibited. Tax policies to encourage businesses to hire older workers should be formulated. The federal government should actively encourage alternative work programs (job-sharing, phased retirement, part-time jobs, etc.) and sponsor job opportunity, placement and retraining programs specifically targeted on older workers.

If a sufficient number of older workers respond to this more aggressive work incentive strategy and increase their work effort, then tax revenues (both payroll tax and general tax revenue) would increase and help to reduce social security's deficit. Raising revenue in order to offset the deficit is far preferable to cutting benefits.

DISABILITY CUTBACKS

The Administration proposes to make it more difficult for all workers--and particularly older workers--to qualify for DI benefits. The proposal includes:

- * use of "medical" factors only in establishing entitlement to DI. Under current law, workers (especially older workers) can qualify for DI based on a combination of medical and non-medical factors (such as age, education, re-employment prospects and work experience). More than one-third of DI beneficiaries age 60 to 65 are determined to be disabled based on non-medical factors.
- * increase the recency of work retirement needed to be insured for disability. Current law requires a worker to have been employed in five out of the preceding ten years in order to qualify for DI. The Administration proposes a work requirement of 7 1/2 years out of the previous 10. This provision would deny benefits to older workers who become progressively disabled and thus have long spells of illness which would prohibit their being able to meet this increased work requirement. Women who leave the labor force for child rearing or other family responsibilities could also loose disability protection under this provision.
- * requirement that a disability be expected to last at least two years (rather than one year as under current law).
- * lengthening of the waiting period for receipt of DI benefits from five to six months.

The combined impact of these four DI proposals would reduce disability payments by $21.9 billion over the next five-year period. These proposals will deny DI benefits to two groups of older workers: those with progressively degenerative diseases and those who are only partly disabled but, because of their age, lack of education or up-to-date skills, cannot be expected to be reemployed.

The Associations oppose these cutbacks in the DI program particularly since they are being proposed along with drastic cuts in early retirement benefits. The combined impact of the DI and early retirement cuts would leave thousands of disabled older workers with no option but to take early retirement and live on extremely low benefit levels for the duration of their later years. If age-62 benefits are to be reduced in any manner as part of a work promotion strategy, then the DI program must be made more, not less, accessible to older workers.

LONG-TERM FINANCING : FUNDAMENTAL REFORM NEEDED

The convergence of demographic, employment and economic trends will make it impossible to continue the system as presently structured into the next century. If perpetuation of social security in such a form is attempted, either a massive payroll tax increase (a near doubling of current rates) or benefit cuts of equal magnitude (through such steps as raising the retirement age and/or price indexing of the benefit formula) will be necessary. Any large payroll tax increase would be incredibly disruptive not only to our economy but also to our political and social fabric. And, if benefits are substantially cut, the elderly will inevitably be forced to sustain a significant deterioration in their living standards and perhaps face the high poverty rates that prevailed in the 1950's and 1960's.

To avoid the unhappy choice between large payroll tax increases and a piecemeal dismantling of the system's benefit protections, we recommend comprehensive reform of the system's benefit and financing structures. This reform must respond to the major trends already unfolding: the adverse economic trends of inflation, low economic and productivity growth which are curtailing the system's financial resources, and the combination of demographic and declining labor force participation trends which portend a larger elderly population becoming heavily dependent upon a smaller work force.

These trends dictate that we begin now to rationalize the social security financing and benefit structures to insure that scarce resources are not wasted and that the financing mechanism used contributes to, rather than detracts from, our future economic health. To achieve these objectives, we suggest that the revamped social security system include the following:

- a benefit structure that would strongly encourage employment on the part of both younger and older workers;
- a more diverse and less inflationary financing structure that would use separate and appropriate tax mechanisms to finance social security's divergent functions of earnings replacement and social adequacy;
- a benefit structure that is equitable in its treatment of individual workers (particularly working wives and single individuals); and
- a benefit structure which provides benefits in a cost-effective and target-efficient manner and which does not overlap or duplicate the benefits provided by other government income support programs.

The current social security structure contains a mix of earnings replacement and welfare/social adequacy features. To further the earnings replacement goal, benefits are very loosely tied to prior earnings histories. To achieve the welfare/social adequacy goal, benefits are computed utilizing a heavily weighted formula which provides higher benefits (in relation to prior earnings) to low wage-earners. In addition, in order to further social goals, benefits are provided to workers' dependents whether or not they have ever contributed to the system.

Pursual of both the earnings replacement and social adequacy goals is appropriate for our retirement income support structure. However, social security has attempted to perform these often divergent and conflicting functions utilizing one benefit structure and one tax mechanism -- the payroll tax. This intermingling of functions, all financed from a relatively regressive tax mechanism, has led to many benefit inequities and much waste and duplication. It has financially prevented the system from fully accomplishing either the earnings replacement or the minimum income guarantee function.

For instance, under the current system, many higher-income persons receive substantial benefits from the system's welfare/social adequacy elements and, ironically, these benefits are largely financed by the tax payments of lower and middle-income workers and their working spouses. One example of this problem would be certain government workers who spend most of their working careers in systems not covered by social security and later work for a short period of time in the private sector, just long enough to establish social security entitlement. In this manner, these workers take advantage of the system's weighted and minimum benefit features which are really meant for long-term, low wage earners. This situation results in a large subsidy to many government employees. That subsidy was estimated to be about $1.9 billion in 1979 ("Social Security and Pensions", Joint Economic Committee, October 1980).

At the same time, many low-income persons who are truly needy and who have borne a disproportionate share of the payroll tax burden throughout their working lives are unable to attain even a bare subsistence level of living on their social security income. These situations have led to the perception by an increasing number of workers that the system's benefit and financing structures are inequitable, wasteful, and not yielding a fair rate of return on their contributions. Wives who work outside the home and single workers are particularly disadvantaged by these structures.

The negative and critical attitudes caused by these inequities can only worsen in the future as demographic and economic cost pressures force combined payroll tax levels above 20 percent. Some policy analysts have argued that since many foreign countries have accepted such high tax levels to support their income assistance programs, so will the American public. What these analysts ignore are fundamental differences in U. S. attitudes toward taxation and government's role in providing public income assistance. If recent behavior is any guide, the American public is not likely to accept the high tax levels required to accommodate demographic trends without scrutinizing who is paying the taxes and how those taxes are being spent, and whether, in this case, the social security system meets its articulated goals in an effective and equitable manner.

To foster public support for the system and to eliminate any unintended subsidies present in the current system, social security's minimum income guarantee/social adequacy function should be clearly separated from its earnings replacement function. The objective of earnings replacement should be achieved through a separate benefit structure which utilizes a proportional (or uniform) benefit formula and is financed from payroll taxes. The objective of social adequacy/welfare should be achieved through a benefit structure which is specifically designed to meet those objectives. This latter structure should be financed out of general revenues which would be generated from more diverse and more progressive tax structures.

Should our nation experience difficulty in resuming healthy economic growth rates in the future or should the cost pressures attendant with the aging of the baby boom population prove more difficult to deal with than we anticipate, then the restructured system we are recommending would allow future policymakers to make clearer decisions on how to allocate existing resources. Choices could be made as to what relative degree the earnings replacement goal or welfare goal should be promoted. These types of coherent choices would be nearly impossible to make under the current structure.

The more focused and target-efficient structure we are recommending, as compared to the intermingling present in the current structure, would be more readily understood by workers and better supported politically because it would stress equity in both its benefit and financing structures. The payroll tax-financed benefit structure would adhere to the principle of individual equity since the payroll tax is a direct and highly visible tax on an individual's wages. The general revenue-financed benefit structure would stress the social adequacy and income redistribution objectives which are more appropriately financed out of general revenues.

In economic terms, this shifting of functions from the payroll tax to general revenues would also help ease some of the financial demands which have been exclusively placed on the payroll tax. These demands will increase in the future as our population ages and as inflation and early retirement trends cause the elderly to become more and more dependent on government programs for support. Given these trends, it is unrealistic -- as well as economically unwise -- to rely solely on the payroll tax to shoulder these burdens. As described earlier, increases in the payroll tax are inherently inflationary and can lead to higher unemployment. Therefore, to the extent we can rely on alternative sources of revenue to fund social security's welfare/social adequacy functions, we will help to avert some of the adverse economic effects of having to increase payroll taxes.

Our proposed restructuring would entail:

* a gradual phase-out of the weighted benefit formula with a simultaneous phasing-in of a proportional or flat benefit formula which would strictly relate benefits to prior earnings/contributions and yield higher primary benefits to workers. The flat benefit formula should be set at 50 to 60% of average indexed earnings so that social security would replace at least half of a worker's pre-retirement earnings.

* a gradual phase-out of derivative benefits (while phasing-in the higher primary benefits) which include spouse, children, student and other dependent benefits. Lengthy transition periods should be provided since these changes are major.

As more married women enter the labor force, it is anticipated that the need for spouse benefits will decline since women will be earning their own entitlement to social security. For those spouses who do not work, it is expected that the higher primary benefits for earners would provide a sufficient level of income. Survivor benefit protection would be automatic.

As these welfare or social adequacy elements are gradually removed from social security's payroll tax structure, new programs should be established (and existing ones improved) so that the welfare/social adequacy functions are fulfilled. For example, to assure benefit adequacy for a worker whose wages were very low or who had sporadic attachment to the labor force, social security would have a separate program with a separate benefit structure financed from general revenues that would supplement the basic earnings-related benefit. If the SSI Program is used to perform the minimum income support function, it must be substantially improved. Federal SSI payment levels would have to be increased to at least 125% of the poverty threshold and the assets test should be abolished.

The Associations believe this type of long-term restructuring will help to relieve cost pressures on the system, and in the process make it a more equitable and therefore popular program. Such reforms will more clearly provide current young workers with the assurance that they will get a benefit from social security that reflects what they earned and paid for and represents a "good buy" in terms of their expected rate of return on investment. In addition, they would have the assurance that, in their later years, they would have good prospects for achieving income adequacy and avoiding poverty. This is an assurance that the system as presently structured cannot provide.

Senator **Armstrong**. Members of the committee, we are now going to invite to come to the witness table, a panel consisting of Ms. Lois Devecchio, of Potomac, Md.; Dr. Rebecca Butler, of Cherry Hill, N.J.; Mr. Mike Callas, of Hagerstown, Md.; Mr. Arthur Michael, of Harrisburg, Penn.

It is my understanding that two of the persons who are going to speak to the committee are recipients of payments under social security and two are taxpayers under the social security system.

May I recognize first Ms. Devecchio.

STATEMENT OF LOIS DEVECCHIO, POTOMAC, MD.

Ms. **Devecchio**. Thank you very much, Senator Armstrong.

I do not have a statement to make other than to tell you a variation on the social security aspect that perhaps has not been brought out to this committee.

I am a military widow. And, inasmuch as my husband did pay into the survivor's benefit, I now receive not only the survivor's benefit but his social security. But, ironically every time you increase the social security, my money goes down as far as the payment that's given to me under the survivor's benefit.

Now this isn't commonly known. Fortunately, the only good aspect of that happens to be that I don't have to pay income tax on the social security that I receive.

However, this just happened and I brought the papers with me just as an example. Under the survivor's benefit, which my husband paid into, I was entitled to $1,436.64 and I was receiving $269.30 in social security. Which, of course, was just fine.

Then when you increased the social security, I still get $1,436.64 because they increased the social security to $299.50 and they decreased the amount of money that I receive from the army.

That means that when you speak of the poverty level, if I had to live on that sum of money, it would be very difficult. Fortunately, someone referred to the double-dippers—when my husband was retired for physical disability at age 55, I was fortunate enough to be able to do work myself. But I could not acquire the 14 quarters that were required to get the social security on my own.

But that doesn't matter. I was able to do other work and to sustain and carry on and still can do so.

But for those widows who are the wives of the service personnel, this is quite a blow when you take away from their survivor's benefits that which was given and give them to the social security.

That is my statement, sir.

Senator **Armstrong**. Thank you very much.

Dr. Rebecca Butler, Cherry Hill, N.J.

STATEMENT OF DR. REBECCA BUTLER, CHERRY HILL, N.J.

Dr. **Butler**. Thank you, Senator Armstrong.

As I appear before you today, I bring with me an immense burden of fear. The social security trustees report issued this week resulted in scare headlines about the system going broke, and this has terrified millions of older people.

You and I, of course, know who the trustees are. But the people I represent don't know them as trustees of the system. They view you, Members of Congress, their elected representatives as the true trustees of the fund.

Congress created the system. Congress established the social contract that is the social security system. Now you must provide the leadership to deal effectively with the problems besetting this system.

In doing this, you must restore the shattered confidence of people who have placed their work, their money, and their trust in the promise of government.

It is being said that social security was never intended to be the sole or primary source of retirement income. That may be true. But it is also true that for millions of people it is their financial lifeline.

I know, as I am sure you do, of people who have worked all of their lives and they have lived from pay check to pay check. They were never able to save money because of circumstances beyond their control. They were never able to buy stocks and bonds or make investments.

Maybe that's not the way it is supposed to be, but that is the way it is.

I know of a woman, for example, and she is typical of millions all over this country who gave up her work life to take care of an invalid mother. And her only source of income is a modest social security check.

I know of a man who is also typical of other men all over this country who gets a social security check of $464 a month.

His net increase from last year's cost of living adjustment was $65.60 a month. The full year's benefit of that increase was wiped out with an inflationary increase in his fuel bill.

This man wrote us in a letter and said 14 percent of nothing is still nothing.

If this Nation can afford to bail out the Chrysler Corp., it can truly fulfill its promises to older citizens.

You are the trustees of the system. And, we are counting on you, our elected officers to make the system work for the benefit of all Americans. Including the elderly who need it so badly.

Thank you.

Senator ARMSTRONG. Thank you, Dr. Butler.

Mr. Mike Callas, of Hagerstown, Md.

STATEMENT OF MIKE CALLAS, HAGERSTOWN, MD.

Mr. CALLAS. Thank you, Mr. Chairman.

I am Michael Callas. I am president of Callas Contractors, Inc., a general building construction firm located in Hagerstown, Md. I am also a member of the Associated Builders and Contractors, ABC. And, on behalf of my trade association's more than 16,000 member-firms with 73 local chapters throughout the United States, I want to thank the committee for the opportunity to testify on the subject of social security payroll taxes as it impacts on individual people.

Our association comprises general contractors, subcontractors, suppliers, associates who promote the merit shop concept of awarding construction contracts to the most responsible low bidders.

Approximately 90 percent of our ABC members are small business employers, all of whom pay the employer's share of the payroll taxes.

Mr. Chairman, as a small businessman who has been engaged in construction for some 30 years, I will direct my short remarks to what I consider to be the burdensome nature of the payment of the payroll taxes by small business employers.

No Government activity directly impacts the American public more than social security and its accompanying taxes. I can assure you that small business people consider payroll taxes the most onerous of all taxes, a greater tax burden than even the income tax.

The majority of us paid more payroll taxes than any other kind of tax. Yet the social security taxes bear little relationship to any operation of our business. The system requires taking a flat percentage right off the top. There are no exemptions. There are no deductions. Social security taxes represent a cost of labor over which the business employer has no direct control whatsoever.

Many businesses are labor intensive. My business—construction—is one. It is generally estimated that labor constitutes between 30 and 40 percent of the construction dollar.

So any inflationary pressures connected to the cost of labor in construction can be devastating to the ultimate cost of our service or product that we produce.

I would like to give you just a quick example. When a contractor estimates the cost of a construction project, the labor hours all the workmen to complete the project are calculated. They are added up together as a direct labor cost. To that total is applied what we call the labor burden.

To arrive at the labor burden, I have itemized in my written testimony seven items starting with FICA taxes at 7.3 percent, unemployment taxes at 3.5 percent, workmen's compensation 6.8 percent, vacation, holiday, sick pay 7.2 percent, group insurance 3.5 percent, pension plan 5 percent, general liability 2.8 percent. In my company, our labor burden is 36 percent of total wages.

This is an average. I think nationally they range somewhere between 30 and 40 percent.

I would like the committee to note, Mr. Chairman, that of those seven items that I am just going over that the FICA tax is the largest contributor to the labor burden. With the present taxable wage base set a level of $29,700 a year, our own company's experience shows that we pay payroll taxes on just about every labor dollar of our payroll every year.

Also, you will note that of the seven contributing items that compose the labor burden, the FICA tax is the only one which the small businessman has no opportunity whatsoever to exercise any type of managerial control. Be it more enlightened supervision of the people in his company, a better safety record to reduce accidents, more closely supervised or better regulated company policies, more accurate recordkeeping. Anything to make it a more viable, profitable, production company.

To further compound the payroll tax burden, these FICA taxes in our company's case, must be paid within 3 days of the date of the wages are paid to the workmen.

Construction contractors, in general, are paid on a monthly basis. The contractors submitting at the end of each month his requisitions on that project for all the labor, material, equipment incorporated in the project the preceding month.

If a contractor is lucky, and I am sure you have heard of this ad infinitum, he will be paid before the end of the following month, a 60-day total period. But in the meantime, the contractor has been required to pay his portion of the payroll taxes each week for every one of those 8 or 9 weeks.

I have just taken a small example here—$25,000 weekly payroll—which is a relatively small weekly payroll for a construction company today with wages being what they are. And waiting that 8 or 9 weeks with the present tax rate of 6.65 percent, we have accumulated in that period of time, and I have a correction in my written testimony, of some $6,600. This added cost of labor is what places such a severe burden on the small businessman. We are financing the payroll taxes to the tune of $6,600 on just a $25,000 payroll for literally 8, 9, or 10 months.

Today it is difficult to arrange for financing to pay the payroll. The payroll taxes not only add to this financial burden, but soak up even what available working capital that we do have. In fact, the cost of these taxes can be the margin of survival for many of our small businessmen today. A look at the mounting IRS lien record will prove my point. Small businesses must have some immediate tax relief. We vitally need this capital to reinvest in our businesses and to provide increasingly scarce working capital.

If the payroll taxes increase after 1981 in accordance with planned escalation with the corresponding increase in the wage base as our National Federation of Small Business has informed us, it is estimated that in order to pay for the currently promised social security benefits, payroll taxes will increase at the rate of something like 20 percent. That is a 50 percent increase.

Many small business people, Mr. Chairman, will be driven to financial ruin. They can't stand a 50-percent increase.

I have touched only on the burden to the employer phase of social security. I would hope this committee would address itself to the many, many other problems that are involved with social security.

Thank you very much, sir.

Senator ARMSTRONG. Thank you, Mr. Callas.

Mr. Arthur Michael.

STATEMENT OF ARTHUR MICHAEL, HARRISBURG, PA.

Mr. MICHAEL. Mr. Chairman, with your permission, I would like to have my wife join me. We are a small business, and we work together.

Senator ARMSTRONG. Well, of course. Welcome, Mrs. Michael.

Mr. MICHAEL. It has been said that behind every successful businessman is his wife who says he is not going to make it. This isn't true.

My name is Arthur Michael, we have two businesses. One near Harrisburg, Pa., and one near Gettysburg, Pa. In Harrisburg, we predominantly put together steel grain bins, crop dryers, feed processing equipment, and steel buildings. In Gettysburg, Pa., we just several months ago bought out an existing John Deere tractor agency. So we have plenty of problems in southern Pennsylvania.

Both of our businesses are directed toward the agricultural industry. I am going to address most of my remarks to the Tam-Agri Corp. that was incorporated in 1974. We have 27 full-time employees.

In the written statement that I have submitted, and I am not going to be reading, but on the last page I have put together a chart. Last year our 1980, total sales were $1,925,000. Of that, $414,000 was paid out in payroll. With what was said here just prior to this which is 21.5 percent of our total sale is labor. So FICA is really hitting us squarely between the eyes.

In fact, in the chart, you will see in 4 out of the past 5 years, we have paid more to FICA than we have Federal income tax. Because of the advantages that we have with depreciation and investment credit, et cetera, we do have a break there. But in 1980 our total contribution to FICA was five times higher than what we paid in Federal income tax.

In fact, our total check to FICA, corporation and employee, and a small corporation of 27 people were paying $1,000 every week into FICA.

The average age of our employees is 33. We have a young work force. Some of us look like we are ready for retirement, but we really aren't. Our oldest employee is 54 years of age.

In the past 5 years, as far as the total contribution to FICA, we have paid in $178,000. We have not collected 1 penny. Our oldest employee is 54 years of age—Jean Owens—if she takes retirement at age 65, we will have paid into the system almost three-quarters of a million dollars.

Will there be anything there for her when she reaches that age?

We are running into a real problem because our employees want a safe, secure retirement plan with the burden that we have from FICA, we can't possibly work in a retirement plan that is going to meet that particular need. My accountant said the last 2 years there is no way we can. There is no way can we do that.

Last year we paid out in FICA, just as the employers share, more to FICA than we paid for utilities, for advertising, and for rent on our facilities. If this continues we have but one choice, and that is to cut back on the amount of employees we are hiring.

I believe our country needs the small business. But with the trend if it continues, there is no way that we can continue to function as a small business. We must cut down.

Thank you, Mr. Chairman.

Senator **Armstrong**. Thank you panelists.

Senator Durenberger.

Senator **Durenberger**. Just one question, Mr. Chairman.

I appreciate Mrs. Michael joining this panel as her husband's partner. Her presence is important to the whole perception of who does business in America that too often we neglect.

Your testimony leads me to ask Mr. Callas, as a representative of small business people in this country, to discuss with us the other burdens that the small business person undertakes in America. I am talking specifically about pension programs.

I would be curious to know among your members, how many of them, in addition to providing for the income security of employees through the social security system, are also providing for them with a private pension system, Keogh plans or IRA's or whatever? And, what general percent of payroll goes into those kind of contributions on top of social security?

Mr. **Callas**. Yes, Senator. Thank you very much for giving me that opportunity because I did want to bring that out in my testimony, but the lights were blinking and I withdrew that.

Let me, first of all, speak for Callas Contractors. In my written testimony under item No. 5, we have an item, group insurance. And we have of our 36-percent labor burden 5 percent attributed to a company—excuse me, pension plan, item No. 6, 5 percent.

We started this—our company is 23 years old—after we were a couple of years old we could easily see that the contributions to social security and the ultimate benefit to social security, and we had a rather young firm, would no way, no way at all, be adequate at retirement age at 65.

So my company purchased a pension plan. It's 5 percent of our wages. We have it integrated with social security, hoping at that time to match some $300 that was estimated to be the maximum benefit.

Today that benefit is in the $500 category. Age 65 1981 dollars—300 and some dollars per month maximum. Our pension plan, and I will give you some figures to support it. Our pension plan, on the average, will triple that benefit and yet we are paying less than our FICA taxes per year. Which brings to mind that the FICA program somewhere along the line is costing more than a comparable benefit plan (and our insurance people give us figures to back this up) than the Government-sponsored program.

You asked about our other members, we have some 16,000 members across the country—I think I can speak for certainly a majority of them, Senator, that they feel the same as Callas Contractors. Their employees are their most important asset. We try to provide as good a benefit as we can possibly afford for our people. But as the gentleman here from Harrisburg indicated, it is the highest tax that we pay.

As I mentioned in my testimony, the social security taxes themselves, in the majority of the cases of the some 12 million small business people are more than even the income tax.

So it is at the end of every week, and as I mention again in my testimony, since we have over $2,000 per week FICA taxes, we have to go to that depository with a check within 3 days. Our comptroller has to scurry on Monay morning to all the coffers to try to not cover all those bouncing payroll checks that we haven't been paid for 60 days, but certainly the FICA tax which is a very, very large portion of our overhead burden.

Senator **Durenberger**. Would you agree with Dr. Butler's assessment that most people are under the impression that we are the real trustees of the income security system in this country? Would you agree that those of us on this committee can't do a good job of providing long-range security for the social security system unless we also do a good job of getting the penalties off of savings and investment in this country and provide incentives for changes in

ERISA legislation and incentives for IRA's and LIRA's. Would you agree that we can't provide long-range income security unless we continue what we started to do in the tax bill this year. That's really the only solution to the long-term income security of the people in this country.

Mr. CALLAS. Yes, sir, Senator, I couldn't agree with you more heartily. We have come. Our construction industry as well as any industry in this country, has come to a skilled labor problem. I am sure that you have this brought up in your State, it certainly is prevalent in my State here in Maryland.

We are coming to the point where there are no skilled people. We can't go out on the street anymore and get a skilled carpenter or cement finisher without training him ourselves.

Those skilled people go where the best dollar is, let's face it. Not so much the top dollar, but where the security is.

I can tell you, in my company, 23½ years old—that we have never had a field supervisor who is considered permanent staff, ever leave our company in 23 years. We have supervisors 17, 18, 19 years. I have often asked why. It has to be the way we have provided under our pension system, and I really wholeheartedly agree to that.

Senator DURENBERGER. Thank you very much.

Mr. CALLAS. Our members across the country, I think—I was national president of our ABC for a couple of years and invariably going across the country, I was in your good State, and the Chairman's good State when we had a chapter started in Minnesota and Colorado. And, one of the things they asked—and those days, this is 10 and 12 years ago—our contractor firms did not have these extra benefits. They paid wages every Friday just like our competition did and ended at that.

They found that you do have to take care of your employees. That will benefit employees at 36 percent, it is very important to keep good people.

Senator DURENBERGER. Thank you.

Senator ARMSTRONG. Mr. Callas, that skilled labor problem is a very pervasive one throughout the economy. Some people think the Senate suffers from the same general problems, but we are trying to put that rumor to rest.

Senator DOLE. We had a big improvement this past year. [Laughter.]

Two years ago also.

First, I'd like to thank you all for coming. I want to extend greetings to the Michaels from Senator Heinz who unfortunately is in Pittsburgh this morning. He asked me especially to extend my best wishes to you.

We had a witness yesterday who had written a book. Maybe other witnesses have written books, but he brought his with him. [Laughter.]

He indicates that one of the biggest problems about the social security system is that many people do not understand it. This is particularly true of those who have become beneficiaries.

As I see it, this is why it is so hard to reform or make changes in social security. No one really understands the system in the first place.

I would like to ask the first two witnesses what their views are. Did you understand, at the time that your husband passed away, just what your benefits would be?

Ms. DEVECCHIO. No; I did not.

Senator DOLE. Sort of like a surprise when you went to the social security office?

Ms. DEVECCHIO. I will say this that I was very surprised. You know you receive it and you are in a state of shock when this happens, and so when social security comes through and so I was equally shocked when I found out that I was being deducted from the money that he had paid in for social security. But, believe me, that $3,600 approximately. That's approximation that I receive from social security is most welcome. And, I am delighted it's there and I am as glad for the benefit and I would hate anything to happen to them. Because unlike many of the wives, when you have had 30 years in the service, living all over the world in which we have done, you don't have time to accumulate that which so many other families can. But, I did not know all the benefits that was accrued to me.

It wasn't that social security didn't put out the information, it is just that we don't think it's going to happen to us, unfortunately.

Senator DOLE. Dr. Butler, what about the people you have contact with? On television we hear people commenting about how Congress may change the system, and it is terrifying, as you have indicated. I think partly so because there is so much misinformation, or lack of information. Some people say "I have paid for it, it's mine." Others say—and I have heard my mother say—that some people get it who shouldn't, because they don't need it. Well, I would like to have your views.

Dr. BUTLER. Yes, I understood the system. And the 13 million members of the American Association of Retired Persons understand it too because that is one of the aspects of our program to make this information known and clear.

Senator DOLE. But do they fully understand? Is there sufficient information coming to those who have not yet retired so that when they do retire they know what their benefits will be and what their options will be?

Dr. BUTLER. Well, prior to this week, many people thought they knew. But because of the news and the headlines, everyone is now in a state of quandary.

Senator DOLE. We are trying not to make that any worse, but there is a need to address some of the problems and we hope to find some long-term solutions. Maybe the Michaels could respond to that question from the business standpoint.

You're talking about the FICA tax, and that certainly isn't the only tax you are paying. I am pleased to know that you have some relief from the depreciation and investment tax credits. There will be more relief on the way. Hopefully we will have the cooperation on the House side to get through some meaningful tax relief this year. You picked a bad year to go into agriculture, but that's another matter.

What about your employees understanding?

Mr. MICHAEL. One of the witnesses said this morning that in a poll that was taken, there was a positive attitude from ages 25 I think up through 50.

We must live in a different area of the world. Because it is all negative. I have an employee 33 years of age, 32 years of age with two children. He resents bitterly the money that he is forced to contribute to this, feeling again, because of press, because of what we are hearing, it is a bankrupt system. So it is really just throwing money away.

He is saying to us, give us something that is safe and secure. Fund it outside of the Government. But again, we are not able financially to do that. We just can't do it. But I would say there is a negative, as far as our average employee is 33 years of age, and there is certainly not a warm feeling because of what is being taken out of his pay each week.

Senator DOLE. Does he understand what's being taken out of his or her pay? They don't want to pay any more social security tax do they?

Mr. MICHAEL. They understand, yes.

Senator DOLE. If you ask them whether they would rather have a phased-in reduction in the growth of benefits, not a reduction in the benefit itself, but a small reduction in benefit growth, or pay more tax, which would they prefer?

Mr. MICHAEL. They would definitely take that which is going to cost them less money today, because at 33 years of age, they could care less about age 65. They are not even thinking about 65.

Senator DOLE. Thank you, my time is expired.

Senator ARMSTRONG. Ladies and gentlemen of the panel, we are very grateful to you. I want to say to Dr. Butler that I share completely your feeling that in the final analysis, Members of Congress are the trustees of the system. Perhaps it is not even an exaggeration to say that in the end, the people of the country are the trustees of their own system because, for better or worse, this is a representative form of government. And, in the long run, attitudes in the Senate, even in the Senate Finance Committee, will be those of the country.

I think, what is obvious even from this panel is that there is a real concern felt among the retirees that is somewhat different than that felt by the people who are paying for the system. So I would like to invite any of the panelists who care to do so to just take a moment to speculate on where we are and to respond to this question.

If you were members of this committee and faced a short-run insolvency next year, and a large, even gigantic long-range deficit, what would you do about it? I recognize that you don't bring to this "a professional expertise," but you have an understanding and an insight that in some ways is more important than that of the actuaries and economists. Would anybody care to answer that question? What would you do?

Mr. MICHAEL. Mr. Chairman, I would just as a layman, and we fight a rearguard action all the time just staying in business solving problems, we elect you men to come to Washington to do that. I——

Senator ARMSTRONG. Very reassuring. [Laughter.]

Mr. **Michael**. I appreciate this opportunity. A week ago they said go out in the sticks and find a small businessman, and so that is why I am here this morning.

But, I am concerned about, we read the same situation in Washington from so many different angles—we really don't know what is truth and what is fiction. I believe the American public is—our employees are that way, they hear the system is bankrupt. So if I were 33 years of age, and I was asked to contribute to this week in and week out, I would be upset too.

If there was some way that we could get the facts, that we would know, this is it. But you listen to CBS you get one thing, you listen to ABC you get another thing. It is amazing that it is all happening at the same place, but when it comes to us—we can't believe this is the same situation.

Senator **Armstrong**. Do you think that this bitter attitude that you ascribe to your 33-year-old employee is a typical attitude, or is it an isolated condition?

Mr. **Michael**. That is a typical attitude.

Senator **Armstrong**. I agree. I hear a lot of that myself. Yes, sir.

Mr. **Callas**. Senator, I would like to address your request for a comment, and also relate to what Senator Dole mentioned when he asked Mr. Michael whether the employee themselves know what the system is all about.

I have an employee, one of our oldest employees, who is a topnotch supervisor, but he only went to the fourth grade.

Some years ago, he objected to the social security tax. He happens to come from West Virginia where they do things almost their own way sometimes. He told me in his own meager mathematical calculation, if he took the money that we deducted from his pay each week, that he has an insurance company that can guarantee him x-number of dollars per year at age 65.

You know, it was something like 10 times what the social security program. Now, we have mentioned here—the panel has mentioned that you and your committee really in reality are the trustees of this welfare plan. It is not an insurance plan—it's welfare.

You asked what you can do. I think the committee should address itself to the whole program. First of all, to cut the fat out of it. You ought to be able to get more dollars benefit for the dollars expended. The business people pay a lot of money. The employees match dollar per dollar. To make it a more viable program, the trustee should get more for their dollar.

Ask us where to start—that's a very, very difficult question.

Senator **Armstrong**. Yes, ma'am?

Ms. **Devecchio**. Senator, as I read it in the papers, I believe that the medicare program is quite solvent and that it would continue so. And yet the social security aspect is not. Isn't there some way that there could be an adjustment made there? Or is that asking too much to try to take from—rob Peter to pay Paul?

I don't know, I am just wondering.

Senator **Armstrong**. Well, it is certainly an option of financing health care from another source. That has been mentioned quite regularly by Senator Durenberger and others. It is a possibility.

Doctor, did you have an observation?

Dr. BUTLER. Yes, I think the first beginning is to start with the belief that we are working with people who love America as I do; who believe in the dream of America; who feel that whatever happens that America is going to keep its commitment to these people who cannot eat, who cannot sleep, who cannot keep warm unless they are beneficiaries of the social security system. I would start with that premise.

Senator ARMSTRONG. A good place to start.

Let me wrap this portion of our hearing up with this observation. I don't mean to put any of you on the spot by asking you what you would do.

I think we are coming down to a fairly narrow range of choices.

When you look at what's happening to the social security system as it is outlined on these charts, it is almost like watching somebody fall off a cliff in slow motion. [Indicating.]

There is no question that we have a horrible problem in the future which, unless we deal with it in some way, will produce some sort of an unacceptable result—either a default of the system, or a payroll tax of far higher levels than we can reasonably expect working men and women to pay. So we have got to do something—it comes down to just a handful of choices, either let the system go belly-up at some point in the future which is obviously not acceptable, or let the payroll tax go through the roof as the chart called "Social Security Costs as a Percentage of Payroll" shows. [Indicating.]

Mr. Callas, if you think it is tough making ends meet when the payroll tax is less than 15 percent as it is now, what do you suppose it would be? And by the way, that pessimistic line is not the design for a ski jump. That is the projected curve of social security costs as a percent of payroll if we don't do something. So I personally rule out a further increase in payroll tax. We are going to have to do something about eligibility standards, or we are going to have to do something about benefits.

So the choices are very, very difficult.

Well, we are grateful to you for your participation this morning. Thank you all for being with us.

Senator DOLE. Could I just make an observation.

Senator ARMSTRONG. Of course, Senator Dole.

Senator DOLE. We are very pleased to have Mrs. Michael here, and we are also pleased to have Mrs. Armstrong here.

Senator ARMSTRONG. Thank you, Bob.

Mr. CALLAS. One parting shot. Has the committee ever considered turning to private enterprise to try to solve this problem?

Senator ARMSTRONG. I would like to answer your question, because I suppose the question that I hear asked more often than any other when I am out talking to town meetings in Colorado, is some variation of what you said. They ask—why don't you turn it over to private enterprise, or why don't you let us opt out of it and provide our own funding through social insurance or something else, privately, and let us off the hook.

The reason that that can't work, in my judgment, is because prior generations of trustees have taken the money that has come in and have spent it and have made promises which aggregate $6 trillion for which there is no money.

So this generation of trustees that you see seated at this table have inherited a problem of enormous proportions. If we just say to everybody, OK, make the best deal that you can in the private sector, that's fine for your 33 year old. It might be fine for a 43 year old. But for the people who have already retired, it means that they are not going to get a check because the prior generations of Senators have made promises without providing any means to keep the promise.

Thank you, panelists, we appreciate it.

[Statements follow:]

STATEMENT BY

DR. REBECCA BATTS BUTLER
CHERRY HILL, NEW JERSEY
MEMBER OF THE BOARD OF DIRECTORS
AMERICAN ASSOCIATION OF RETIRED PERSONS

BEFORE THE SOCIAL SECURITY SUBCOMMITTEE
OF THE SENATE FINANCE COMMITTEE
FRIDAY, JULY 10, 1981

Thank you, Senator Armstrong.

I appreciate being invited to join you here today.

I bring you an immense burden of fear.

The Social Security Trustees' report issued this week resulted in scare headlines about the system going broke. This terrified millions of older people.

You and I, of course, know who those trustees are. They are Administration appointees. And they may have used the statistics involving the Social Security funds to help accomplish other Administration purposes.

But the people I represent don't know them as trustees of the system. They view you -- members of Congress -- as the true trustees.

Congress created it. Congress has made changes over the years to improve it. Congress established the social contract that is the Social Security System.

You must now provide the leadership to deal effectively with the financial problems. You must also restore the shattered

(MORE)

confidence of people who have placed their work, their money and their trust in the promises of government.

It is being said that Social Security was never intended to be the sole -- or primary -- source of retirement income. That may be true. But it is also true that for millions of older people, it _is_ their financial lifeline. They didn't plan it that way either.

I know, as I'm sure you do, people who worked all of their lives in low-paying jobs. They lived from paycheck to paycheck. They were never able to save money, buy stocks and bonds or make investments. They never had a pension program. Now, in the last years of their lives, the fact is that the Social Security system is their sole source of support.

Maybe that's not the way it is supposed to be, Senator, but that's the way it _is_.

I know a woman, for example, who gave up her work life to care for her invalid mother. Today, her _only_ income is a modest Social Security check.

I know of a man who gets a Social Security check of $464 a month. His net increase from last year's Cost of Living Adjustment was $65.60 a month. The full year's benefit of that increase was wiped out with an inflationary increase in his fuel bill.

He wrote us to say: "Fourteen percent of nothing is still nothing."

If this nation can afford to bail out the Chrysler Corporation, it can surely fulfill its promises to older citizens.

You are the true trustees of the System. And we're counting on you to do it.

# # #

Statement of
Michael G. Callas
on behalf of
Associated Builders and Contractors, Inc.

Mr. Chairman, members of the committee, I am Michael G. Callas, President of Callas Contractors, Inc. of Hagerstown, Maryland. I am also the past president of the Associated Builders and Contractors, Inc. (ABC) on whose behalf I am appearing today.

ABC is a nationwide trade association of more than 16,000 firms with 73 local chapters throughout the United States. Its membership includes general contractors, subcontractors, suppliers, and associates who promote the Merit Shop philosophy, a concept which calls for contract award to the lowest responsible bidder. Approximately 90% of ABC's members are small businesses. And, of course, each of ABC's more than 16,000 members is required to pay the employer's share of social security taxes.

As a small businessman who has been engaged in construction for over 30 years, I will direct my short remarks to what I consider to be the burdensome nature of the payment of payroll taxes by all small business employers. No government activity directly impacts the American public more than social security and its accompanying taxes. I can assure you that small business people consider social security payroll taxes the most onerous of all taxes -- a greater tax burden than even the income tax. A majority of us pay more payroll taxes than any other kind of tax.

Yet these social security taxes bear little relationship to any operation in their business. It instead requires taking a flat percentage right off the top. There are no exemptions; no deductions. Social security taxes represent a cost of labor over which the employer has no control whatsoever.

Many businesses are labor intensive. Construction is one. It is generally estimated that labor comprises 30 to 40% of the construction dollar. So any inflationary pressure connected to the cost of labor can be devastating to the ultimate cost of a service or product. For example, when a contractor estimates the cost of a construction project, the labor hours of all the workers needed to complete the job are calculated and then added together. This subtotal is then added to what is commonly called the "labor burden". The "labor burden" is determined as follows:

FICA taxes		7.3%*
Unemployment compensation taxes		3.5%
Workers compensation insurance		6.8%
Vacation, holidays, sick pay		7.1%
Group insurance		3.5%
Pension plan		5.0%
General liability insurance		2.8%
Labor Burden	=	36.0% of total wages

---

*/ Higher than the statutory percentage because of taxes paid on vacation, holidays, and sick pay.

Note that the FICA tax is the largest contributor to the "labor burden". With the present taxable wage base set at a level of $29,700 per year, our company's experience shows that we pay social security taxes on just about every **dollar** of our total payroll. Also please note that of the seven contributing items that comprise the "labor burden", the FICA tax is the only one over which the small business **has no** opportunity to exercise some type of managerial control -- by more enlightened supervision, a better safety record, better regulated company policy, more accurate recordkeeping, etc.

To further compound the payroll tax burden, these FICA taxes (in our company's case) must be paid within three days of the date wages are paid to the workers. Construction contractors are usually paid on a monthly basis -- the contractor submits at the end of each month a requisition for the labor, materials, etc. incorporated into the project during the preceding month -- a 60 day total period. But during that month, the contractor has been required to pay his portion of the social security taxes each week for eight to nine weeks. For example, $25,000 (weekly payroll) x 2 months average time x 6.65% (present tax rate) = $1,663 (total payroll taxes). This additional cost of labor places a severe burden on the small business.

Today it is difficult enough to arrange financing weekly wage costs. These payroll taxes not only add to this financial burden, but soak up more of our available working capital. In fact, the cost of these taxes can be the margin of survival for many small businesses today. A look at the IRS lien records will prove my point.

Small businesses must have some immediate payroll tax relief. We all vitally need this capital to invest in our businesses and to provide increasingly scarce working capital. If the payroll tax increases after 1981 in accordance with the planned escalation with a corresponding increase in the wage base, it is estimated that in order to pay for the currently promised social security benefits, payroll taxes will have to increase to a combined rate of over 20% -- a 50% increase. Many small businesses will simply be driven into financial ruin.

I have addressed only the burden to the small business today. I hope that this committee will also address the other serious problems which exist in the social security system.

Mr. Chairman, members of the committee, this completes my formal testimony. I want to thank you again for providing ABC with this opportunity to present its views on this important issue. I will now be happy to answer any questions you may have.

Senator ARMSTRONG. Members of the committee, we are now going to hear what I believe is going to be an extraordinarily interesting presentation—not only because of the people who are going to make it, but because of what I believe will be the main thrust and direction of the testimony.

We are very pleased to welcome a distinguished colleague of ours. A former member of the Congress of the United States from Massachusetts, Mr. Hastings Keith, who in addition to bringing to this task some expertise gained as a Member of Congress, is also a project manager of the Aspen Institute Workshop on Public Employee Pensions. He knows a lot about this from more than one perspective.

Joining him will be Mr. John W. Macy, Jr., former Chairman of the U.S. Civil Service Commission, Director of Federal Emergency Management Agency.

Gentlemen, we are delighted to have you with us. Thank you for coming.

STATEMENT OF MR. HASTINGS KEITH, FORMER CONGRESSMAN FROM MASSACHUSETTS, PROJECT MANAGER, ASPEN INSTITUTE WORKSHOP ON PUBLIC PENSIONS

Mr. **Keith.** We are delighted to be here in spite of the introduction which you inadvertently gave as you reminded the Members of the Senate and others in this room that it was the Congress who had put us in this box.

Senator **Armstrong.** That is right, you are one of the earlier generations of Congressmen—could you account for how you got us into this mess? [Laughter.]

Mr. **Keith.** I think I can, but I can't tell you how to get out of it. [Laughter.]

Mr. **Macy.** I should add for the benefit of my associate that this is really a session of mea culpa, because we have been involved in creating some of the conditions with which you are attempting to deal at the present time.

We feel that it is an act of courage to come back and face you and see if we can help resolve some of the problems that we have perhaps been a party to initiating.

Senator **Armstrong.** Well, we are eager to hear your testimony, because we can use all the help we can get.

Mr. **Keith.** I have a prepared statement which I am submitting for the record, and I have a preface which I wrote this morning in good conscience as my troubled sleep was interrupted.

My Federal pensions as a former Congressman and as a reservist and as a civil servant now total $1,000 a week—$52,000 a year. The fact that all of this $52,000 is completely indexed, makes it, without question, one of the sweetest deals anyone could ask for. The fact that my wife will inherit about 60 percent of it—whatever it amounts to—at my death, and without any estate tax, makes it even nicer.

When one considers that I am getting social security of about $8,400 a year on top of it, it becomes a bit too much.

As far as the congressional/civil service pension is concerned, I paid about $36,000 for it, and it now counts for about $42,000 of the $52,000 I am getting.

The military portion of my pension didn't cost me much. Almost 6 years of active duty—which I loved.

The social security pension which is the soundest element in the whole pension package was bought and paid for during 45 years of relatively productive work.

Put it all together, and I have got a pretty good deal, and so has my wife should I predecease her. But what about my children and the other young people who are already feeling the crunch in their social security and income tax bills?

If I didn't help my children out once and a while, they would be hard pressed to pay for a home and the other amenities that today's young parents like to have.

My enviable pension position is unique insofar as the magnitude of the pension benefits is concerned. But it is safe to say that the average pension of the average Federal retiree is far greater than that of the average citizen whom he represents to serve as the case may be.

Certainly the civil servant, whether he is retired or on the job, is far better able to pay his bills and his taxes than the average retired, or even the employed shoe, textile, or autoworker.

I realize that there are many facets to this problem of social security. How much should it cost, and how much should it pay out at death or when disability strikes, or at retirement? But there is one thing to me that is very evident. The civil servant, whether he is a Congressman or a streetsweeper, should pay his fair share and should get his fair share.

The House Ways and Means Committee so concluded when, in 1977, they recommended that Federal employees be covered under social security. But the postal employees and others descended on the House, they flooded the mails, they filled the galleries, they persuaded the House to adopt the Fisher amendment and to defer congressional action until studies could be completed.

Well, all the studies have been completed, and all the reports are in, and they all support universal coverage. But the Federal employees or retirees have been busy too. Who will win out?

Outside of Washington, there is no question, the editorials have been almost universal in their support of universal coverage. And, even in Washington, as a sense of the sentiment, it is in favor of universal coverage. But the power of the phone calls from the highly motivated, but misinformed Federal employee retiree can still influence the Congress. I hope that your committee, whose members in large measure shape the fiscal policy of our Nation, will be guided by the sense and wisdom of those who have studied the questions of universal coverage and concur in their recommendations that it be extended to Federal employees as soon as feasible. And, it would seem to me, that the best way to show confidence in that system would be to sign up the Members of Congress and the Federal employees in the system so that it could have the benefit of their strength.

Thank you.

Senator **Armstrong**. Thank you, Mr. Keith. Before we go to the committee, let's hear from Mr. Macy.

STATEMENT OF JOHN W. MACY, JR., FORMER CHAIRMAN, U.S. CIVIL SERVICE COMMISSION, FORMER DIRECTOR OF FEDERAL EMERGENCY MANAGEMENT AGENCY

Mr. **Macy**. Thank you, Mr. Chairman. I appreciate the opportunity that you and members of the committee have given to Congressman Keith and to me to talk about yet another facet of the social security issue. That relating to the largest employer in the country, and the one whose personnel policies and benefits are determined by the Congress; namely, the civilian and military personnel of the Government.

As Congressman Keith has indicated, there are instances such as his where very substantial benefits have been gained through the existing retirement systems. Both Congressman Keith and I became concerned about the magnitude of these problems, as reflected not only in funds obligated by the Federal Government, but in terms of burdens placed upon coming generations who will have to support these particular plans.

Because of my previous association with both the Civil Service Commission and the Social Security Board, I have a longtime interest in, and support for, the issue of universal coverage. That is the coverage of Federal/civil employees under the Social Security Act.

The history of the act was one of evident intent that there be universal coverage, and that the social security pension plan form a foundation for pension plans of private and public employers.

Today we have one notable gap in that coverage; namely, the civilian employees of the Federal Government who are covered by the Federal Civil Service Retirement Act.

Even though there have been many studies as my predecessor indicated, all of those studies supporting universal coverage, there has not been enactment at any time since the Social Security Act was passed in 1935.

We are here to urge that as you consider the other issues that are crucially reflected in these charts, that you also give consideration to extending coverage to Federal employees. It is our belief that that extension would resolve a number of the issues that relate to civil service retirement at the present time. These are issues that arise out of a system which permits early retirement without an actuarial reduction in the annuity to be paid. It is a system which is highly liberal as far as disability retirement is concerned, so liberal that about 30 to 40 percent of those that retire, retire on disability.

We have a system which has existed since 1962 which provides for an indexation of the annuity in order to preserve the purchasing power of the earned annuity.

That particular move was one that was designed to provide a rational basis and a sound policy for adjustments in annuity rates.

In passing that legislation, there was no anticipation of the inflationary trends that subsequently ensued.

So today we have a system where through one or two adjustments a year the value of the annuity is substantially increased. Increased to a far greater degree than is the case in the adjustments for social security.

So, Mr. Chairman, as the light has gone on, I offer a written statement which expands upon the observations that I have made here. And, I conclude in urging that the committee give consideration to the issue of universal coverage to the extent that there be social security coverage for Federal retirees, not as an additive feature, but as an integrated feature so that in truth the Federal pension system will match the system that is applied in most private employment situations.

I appreciate the opportunity to offer these observations, and I am available to the committee now, or later, to provide any kind of assistance that may be useful in dealing with this particular issue.

Thank you, Mr. Chairman.

Senator Armstrong. Thank you, gentlemen.

Senator Durenberger, would you care to ask any questions or comment on what has been described as "one of the sweetest deals anyone could ask for"?

I believe that is the way that you characterized your retirement?

Mr. Keith. I did.

Mr. **Macy**. That is a more moderate expression than he usually uses.

Senator **Armstrong**. Before I yield to Senator Durenberger, I can't help observing that if the pay of Senators remains capped as it has been, and as I anticipate it will be, it won't be very long before you are going to be making far more in retirement than current Members of the Congress make for working. And, of course, a portion of what you are receiving is not subject to tax. So it really is a "sweet deal."

Senator Durenberger.

Senator **Durenberger**. Thank you, Mr. Chairman, I am going to pass up the opportunity to talk about the sweetness. Let me ask you, Mr. Macy, about the issue of universal coverage because later this morning we are going to hear some very different views on that subject.

There is clearly, as you indicated, one major gap in universal coverage and that's Federal employees and those of State and local government.

One of the major advantages that Federal employees have over other employees in this country is the prevalence of early retirement. With this advantage goes the encouragement to get into other employment—usually social security-covered employment.

If you look at the gross statistics, we have 90 percent of the employed population covered by social security, but we have 95 percent of the retirees collecting social security. Some of these retirees have been receiving social security benefits with relative ease after 4 or 5 years of covered employment. This time requirement is now up to 6½ years of covered employment.

Would you have some sort of startup recommendations for us as we consider the issue of universal coverage? as to how we might progressively move in that direction?

Mr. **Macy**. The process of moving into integration clearly is a difficult and complicated one. The least painful process would be to apply it prospectively. That is to apply it to those who enter employment at some specified date in the future, and to continue the existing plan for everyone else.

I believe that it should be possible to phase it in so that that particular plan would not be necessary. By having a certain portion of the retirement deduction applied to social security so that benefits are given at an earlier date than the retirement of those entering the service at the present time.

I believe that we have a deceptive situation today where we have a very high percentage of those who are receiving this "very sweet deal," are also covered by social security. And, because of their limited eligibility coverage in employment, they are receiving the advantage that was put into the law to take care of those with very low income.

I participated in the 1960's in the development of a plan for the application of integration which was conducted jointly with Robert Ball, who was then the Commissioner of Social Security. It was filed with the body in the other House that had jurisdiction.

I never heard what happened to that study. It went the way of all studies that are opposed by an overwhelming number of my colleagues and former colleagues in the Federal service.

Mr. KEITH. Could I comment?

Senator DURENBERGER. Please.

Mr. KEITH. I would like to, I hope, have you correct the impression that I got when you said we, or I, won't have the courage to do it for the present employees.

I think that you will find that there has been lots of integration of previous plans of public employees in the States and in Federal agencies as well where they have been able to do it.

There are people who have the competence to direct you to do it, as to how it should be done.

Frank Crowley, the staff director of the Universal Commission Coverage set up by the House, would be one. Pres Bassett would be another who thinks—I believe he is going to testify later on—that it would be fairly easy to do it for the Federal Government, but not for the State government.

Joe Bartlett, an Undersecretary of Commerce, and Milton Gwertsman—these are the men who led the other study groups or advised them, and so concurred that it could be done much more readily? The savings are tremendous.

Mr. MACY. May I add too to the Senator's response? The Tennessee Valley Authority, a part of the Federal family, has adopted a plan of where there is an integration with social security, and where the financial picture is substantially improved over that of the civil service retirement provisions. I believe that could be a model worthy of study by the committee and others interested in this issue.

Senator DURENBERGER. Thank you.

Mr. MACY. I think it is important to recognize, Mr. Chairman, that the coverage of Members of Congress under this plan, with a formula that is more beneficial than that available to others covered by the law is a factor that probably tends to deter any changes in the Federal Civil Service retirement provisions.

It would seem to me that some leadership by the Congress with respect to its own retirement benefits might be salutary in dealing with some of the issues that are involved.

Senator DURENBERGER. I would just say very briefly to that, Mr. Chairman, that those of us that are cosponsors of the constitutional amendment legislation to limit the terms of Senators and House Members should not be included in that characterization of Members of the Congress.

Senator ARMSTRONG. Duly noted.

Senator DOLE. I want to make a point with Congressman Keith. I wouldn't want to leave the impression that only former Members of Congress can put together little packages like this. Knowing the press, if that's the case, they will focus on it—if it's not, it will be forgotten. [Laughter.]

Can other Federal employees cook up the same little package?

Mr. KEITH. Yes, they can and do relative to their own much smaller salaries. But, the most beneficial of them all, of course, as it was mentioned many times here today, is the person gets a subsidized social security benefit.

But, the benefit formula for a civil servant is, on its own, one of the most generous in the Nation. That is spelled out here.

I would point out over on this chart the social security costs as a percentage of payroll. The civil service pension as a percent of payroll now takes almost 40 percent, and if they had to comply with ERISA, it would take 79.8 percent of payroll to provide benefits such as we now enjoy; 79.8 percent of payroll.

So, as you can see, it is in the disaster range already.

Senator **Dole**. We get a lot of letters, as both you and Mr. Macy know. People are out there paying taxes who know we are not covered by social security. There are some who would cover Members of Congress if we didn't cover anybody else in the Federal System. Maybe we could answer our mail with less effort, but as far as addressing the problem of universal coverage, that really wouldn't solve any problems.

An amendment was offered in committee to do just that, in 1977 I believe. The vote, as I recall, was 15 nays to 4 yeas. I don't know whether the four who voted yea are still with us or not.

You understand, the Federal employee unions feel very strongly about this.

Mr. **Macy**. I am aware of that. I have been unpopular for many years.

Mr. **Keith**. We do know, of course, that like myself, most Members of Congress have some other sources of earned income that we enter on our income tax forms—honorariums for speaking engagements and things of that sort. That qualifies us. I think there is only one Member of Congress that had sufficient years and yet never applied for his Federal pension, and that was Senator Saltonstall.

Senator **Dole**. I appreciate very much your statement. It points up the other side of an area that we need to address.

By the way, the other day, you were telling me about the 1 percent kicker Federal employees received because they were so downtrodden. Have you figured up the cost of that if we had kept that in effect?

Mr. **Keith**. Robert Myers gave me the statistics on that and when I conveyed them to the Reader's Digest and the Wall Street Journal Members of Congress heard from their constituents. At a 12-percent rate of inflation for the people who were then retired, and their surviving spouses—assuming of the people who were then retired would live 15 more years and half of them would be survived by a spouse and who would live 10 years, the cost for that benefit of the 1-percent add on over and above the cost of living was $384 billion.

Senator **Dole**. $384 billion? That's with a "B."

Mr. **Keith**. "B" as in billion.

At a 6-percent rate of inflation, it would have been about $87 billion.

If the Congress had frozen that pension at that time until such time as the cost of living caught up with them, they would have saved an additional $37 billion.

I am getting a $200 increment that was left in my pension at that time. It is now about $300 a month from that $200.

So my pension is 10 percent richer because of the existence of that increment which is still in my pension.

If you are looking for $37 billion, that is one way to get it.

Senator **Dole**. I'd take a look at that.

The point I want to make is that it is easy to understand why some of the previous witnesses, Mr. Michael, Mr. Callas, and others who are out there trying to survive, are frustrated with the stories they hear and read. I don't suggest that the press is doing anything but report the facts. But, it is difficult for those in the private sector, struggling along, to see the generous benefits we dump upon ourselves.

Thank you.

Not dump, but reap.

Mr. **Macy**. Senator Dole, just an added point. I think the emphasis on retirement and the emphasis on pay for active service tend to get out of phase here, too. For some reason it is almost sinful to increase executive or congressional pay. But the magnitude of these retirement adjustments that occur do not receive the same kind of critical attention in the public interest.

Senator **Dole**. Well, that's because we raise everyone but the Members of Congress, but we are working on that.

Mr. **Macy**. It may very well be that the retirement implications of that raise should be considered at the time that that issue is debated.

Senator **Armstrong**. Senator Grassley.

Senator **Grassley**. In regard to universal coverage, it is my understanding, and hence I am asking you to either verify it or correct me, that universal coverage does bring a lot of money into the social security system early on to take care of the short-term problem. But over a period of 20 to 30 years and beyond, isn't the income and the outgo just about the same? And, if that is the case, then hence toward the long-term solution of the program, what's the sense of including a classification of people who have their——

Mr. **Keith**. Because you would get rid of this tremendous liability that I referred to earlier for the public employee pension.

The unfunded liabilities——

Senator **Grassley**. OK, so you're using it as a solution to take care of unfunded liabilities to the civil service retirement system, not as a help to the social security system?

Mr. **Keith**. I am looking at it as a way to help the Government balance its budget.

This $403—as of September 30, 1979—$403 billion of unfunded liabilities for the civil service; $446 billion for the military; roughly $3 billion for the foreign service.

Now in the TVA, and in the case of the employees of the Federal Reserve System, there's practically no unfunded liability. They are integrated.

Senator **Grassley**. The merging of the program into what you call an integrated system then, is what's got to be the end result. You don't propose then that we have civil servants pay into the civil service retirement system and the social security system and draw out of both.

Mr. **Keith**. It is just a matter of equity. We shouldn't have a bunch of people supervising and directing the Federal Government who are not a part of the system which they impose upon others. We are, in effect, enjoying a very, very plush pension system.

Senator GRASSLEY. Am I right in regard to civil servants paying into the social security system? That's only a short-term solution to the problem. Long term presumably what they pay in, they draw out. Just like any other class of worker.

Mr. KEITH. Absolutely.

But the end result is that, if we had universal social security coverage a worker could be compensated more in proportion to the work expended for his fellowman or in production.

The pay that we are getting when you consider pay comparability, and factor in the retirement benefits, is entirely disproportionate to any service that we might have rendered.

Mr. MACY. I think it is important that it be clear that we are not espousing universal coverage as the route toward resolution of the financing problem.

But, in terms of equity and sound public policy, both for the taxpayer and for the Federal employee; because our view is that many of the Federal employees are at the present time facing an unsatisfactory retirement situation because there is not social security coverage.

Mr. KEITH. In my prepared statement, I go into some detail as to what the Federal employee loses in this system. The 20-odd percent that never collect anything out of it. They leave their Federal employment very quickly and they have their families that are unprotected in a period immediately following before they become qualified for social security.

Senator GRASSLEY. You never really hear from those people.

Mr. KEITH. No, you don't. They are outnumbered.

Mr. MACY. Well, they tend to be unrepresented. They are usually younger employees with relatively short tenure; and with the absence of an expectation that they will make a career in the Federal Government.

Mr. KEITH. They are the members of your staff.

Senator ARMSTRONG. Thank you, Senator Grassley.

Senator Long.

Senator LONG. No questions.

Senator ARMSTRONG. Gentlemen, we are indebted to you for your testimony.

Thank you for sharing it with us.

I anticipate that you will hear from a large number of Federal employees, some of whom are probably waiting for you in the corridor.

Mr. KEITH. I can't get out without giving a little plug for the little booklet that I wrote—it's called "Targeting Federal Pensions, Unplayed Ace in the Anti-Inflation Deck." It appears in the May issue of Enterprise magazine published by the National Association of Manufacturers. It is not as big as Hayworth Robertson's, but it is much more reasonably priced.

Senator ARMSTRONG. Thank you very much for letting us know about that. I——

Mr. MACY. And, I'm not going to plug my book.

Senator ARMSTRONG. Well, this week, we are inviting comments about publications, so this is a good forum. If you have got anything that you would like to mention, this is the time to do it.

Mr. MACY. Thank you very much, Mr. Chairman.

Senator **Armstrong**. Thank you, gentlemen.

[Statements follow:]

TESTIMONY OF HASTINGS KEITH, FORMER MEMBER OF CONGRESS

My federal pensions—as a former Congressman—and as a Reservist—and as a civil servant—now total a $1,000 a week—$52,000 a year! The fact that all of this $52,000 is completely indexed makes it without question one of the sweetest deals anyone could ask for. The fact that my wife will inherit about 60 percent of it, whatever it amounts to, at my death—and without any estate tax, makes it even nicer. And when one considers that I am getting Social Security of about $8,400 a year on top of it, it becomes a bit too much.

As far as the Congressional/Civil Service pension is concerned I paid about $36,000 for it—and it now counts for about $42,000 of the $52,000.

The military portion of my pension didn't cost me much—almost 6 years of active duty which I loved.

The Social Security pension—which is the soundest element in the whole pension package—was bought and paid for during forty five years of relatively productive work.

Put it all together and I've got a pretty good deal and so has my wife—should I predecease her.

But what about my children—and the other young people who are already feeling the crunch in their social security and income tax bills. If I didn't help my children out once in a while they would be hard pressed to pay for a house—and the other amenities that todays young parents like to have.

My enviable pension position is unique insofar as the magnitude of the pension benefit is concerned but it is safe to say that the average pension of the average Federal retiree is far greater than that of the average citizen whom he represents or serves as the case may be. Certainly the civil servant whether he is retired or on the job is far better able to pay his bills and his taxes than the average retired or unemployed or working shoe, textile or auto worker.

I realize that there are many facets to this problem of social security—how much it should cost and how much it should pay out at death—or when disability strikes or retirement. But there's one thing that to me is very evident: the civil servant whether he is a Congressman or a street sweeper should pay his fair share—and should get his fair share.

The House Ways and Means Committee so concluded in 1977—but the postal employees and others descended on the House—they flooded the mails—they filled the galleries—they persuaded the House to adopt the Fisher Amendment—and to defer congressional action until studies could be completed.

Well, all the studies have been completed and all the reports are in and they all support universal coverage. But the Federal employees/retirees have been busy too. Who will win out?

Outside of Washington there's no question the editorials have been almost universal in their support of universal coverage—and even in Washington, as I sense the sentiment, it is in favor of universal coverage.

But the power of the phone call from misinformed but a highly motivated but misinformed Federal employee/retiree can still influence the Congress. I hope that your committee whose members in large measure shape the fiscal policy of our Nation will be guided by the sense and wisdom of those who have studied the question—and concur in their recommendations that it be extended to Federal employees as soon as feasible.

The most important matter before the Congress now should be that of Universal Coverage, probably the most misunderstood and misconstrued issue that this subcommittee will consider in this period of evaluation of the program and its future.

Here in Washington one would get the impression that mandatory coverage of all public workers is abhorent to the taxpayers of this society and political poison for any Senator or Congressman who supports it. The unions representing Federal workers have amassed millions of dollars to fight mandatory coverage. They argue that such a measure would ruin their retirement plan, raise the cost of public retirement to the taxpayers and unfairly victimize a small segment of the workforce to help set the Social Security house in order.

It is important that both you and the public know and understand certain facts:

(1) *The lack of Social Security coverage victimizes many Federal workers.* Social Security is the portable underpinning of the disability, survivor and retirement system in this nation. More than 90 percent of all current workers enjoy his portable protection. Workers who move between covered and noncovered jobs do not get this protection. For example, 62 percent of newly hired Federal workers will

never draw a Civil Service Retirement System (CSRS) pension benefits. Nearly 25 percent of all current Federal workers will not receive Federal pensions. More than 21 percent of Federal workers who are now vested in CSRS will leave Federal employment before being eligible for a pension and will eventually withdraw their contributions. It is hard to justify the social obligation of private employers to provide portable protection for its workers when those who make the policy exempt themselves.

(2) *Social Security is a redistributive program.* It provides more generous benefits to low-wage earners than high income workers. "Part of the payroll tax contributions of high-wage covered workers are used to provide more generous benefits to retirees with low-average lifetime earnings than they would otherwise receive if Social Security were not tipped to favor low-income workers. The high paid noncovered workers do not share this burden. There is nothing inherently different in the employment of noncovered workers that differentiates their work from that of covered workers. There are accountants, lawyers, economists and actuaries, blue collar workers, clerks and secretaries in both the covered and noncovered sectors.

It should be kept in mind, however, that some noncovered employees are low-paid workers who would actually benefit from expanded coverage. Women, for example, would benefit from wider Social Security coverage. Approximately 28 percent of women employed by the Federal government in April 1978 had annual salaries below $10,000, compared with 7 percent of the male Federal Employees. Only 8 percent of the Federally employed women had salaries above $20,000 in 1978, compared with 31 percent of their male counterparts. Similarly, minority employees would also benefit from the redistributive aspects of Social Security. Only 12.9 percent of whites employed by the Federal Government had annual salaries below $10,000 in April 1978, compared with 19.4 percent of minority Federal employees. In comparison 11.6 percent of minority workers had salaries exceeding $20,000 per year while 27.5 percent of white Federal workers had salaries exceeding this level in April 1978.[1]

(3) *Partial participants in Social Security are afforded "unwarranted bonuses" when they receive benefits.* The Congress foresaw this problem and warned against it as early as 1939.

"An average wage formula will also have the effect of raising the level of benefits payable in the early years of the system, but it will reduce future costs by eliminating unwarranted bonuses payable under the present formula to workers in insured employment only a few years. These bonuses result from the greater weight now given to the first $3,000 of accumulated wages. They are justified, if a total wage formula is used, in the case of older and low paid workers who retire in the early years of the system and have not time in which to build up substantial benefit rights. In the long run, however, such bonuses are unwise and endanger the solvency of the system by permitting disproportionately large benefits to workers who migrate between uninsured and insured employment and accumulate only small earnings in insured employment.[2]

"The Social Security bonuses to noncovered workers result from two factors: (1) the benefit formula provides a deliberate subsidy intended for workers with a lifetime of relatively low wages; and (2) the benefit calculation does not distinguish between truly low-wage earners and those who average lifetime covered earnings are low because they work primarily in uncovered employment. The "unwarranted bonus" concept has as underlying premise that Social Security should treat workers with comparable earning patterns comparably.

Sylvester Schieber, a former policy analyst for the Social Security Administration, now with Employee Benefits Research Institute (EBRI) pointed out in a AEI paper (June 2, 1981) that these unwarranted bonuses this year will exceed $2 billion. He also pointed out, that like other elements of the program, these bonuses are indexed and will grow in the future. Further, if all Federal workers who were more than 10 years from retirement on January 1, 1982 were covered on that date, more than $35 billion in new Social security revenues would result in the first five years. Their retirement program would have to be modified to account for the coordination with Social Security. Such a revised retirement package has been developed by the (this study was conducted by a Task Force headed by former Under Secretary of Commerce Joseph Bartlett) Universal Social Security Coverage Study. The analysis in Chapter 5 of that study shows that:

> Average Federal retirement benefits do not have to decline under a coordinated system.

---

[1] Schieber, Sylvester J., AEI paper, pp. 3–4.

[2] House of Representatives, 76th Congress, First Session, Report No. 728 Social Security Act.

Federal pension costs do not have to rise—they only rise if additional benefits are provided.

The elimination of the unwarranted bonuses now provided by social security will result in a substantial savings to the taxpayers.

Social Security coverage would provide added protection to mobile Federal workers, to minorities and to women.

All of this confirms the logic of other studies which were authorized as the result of the legislative fiasco of 1977. Most of you will recall that the Ways and Means Committee in 1977 proposed Universal Social Security coverage—but when the federal employees and retirees got into the act they persuaded the House (the Fisher Amendment) to postpone consideration until the matter had been studies yet another time.

These employees and retirees have been most successful in protecting what they consider to be their turf.

For years their leadership has fought to preserve a retirement plan which provides the federal employee with the most generous pension plan in America. A plan which if it is not radically modified will be so expensive that the tax burden could increase that cost of production until we are priced out of world markets.

The cost of this plan if it were to be provided for all of the nation's commerce and industry would add more than 450 billion dollars to the cost of doing business in America.

We obviously can not afford to impose such a burden upon economy.

The public has learned in recent weeks a great deal about the Social Security system. They have yet to comprehend the Social and fiscal problems related to the Civil Service Retirement Plan. But sooner or later they will learn—and when they do they will most certainly insist that the bureaucrats not enjoy a standard of living that is beyond the capability of the private sector taxpayer to support. We, it seems to me, are fortunate, in that you as senators, acting in the broader sphere of public interest can recognize and correct the inequities that are inherent in double standard retirement communities.

It was the initiative of this body that forced the house to acceed to the Chiles and Hollings amendment of 1976 which eliminated the 1% kicker, and saved the nation an estimated $384 billion. The same forces are at work and the same opportunities exist here today. The arguments for Universal coverage are even stronger than they were in 1977. It is in yours and the nation's long run and short run interest to provide universal coverage for all Americans—and then to make the system work.

Senator ARMSTRONG. Members of the committee, we are pleased to welcome next a panel of witnesses who will represent, broadly speaking, American labor.

Mr. Robert McGlotten, associate director of the Department of Legislation, and Mr. Bert Seidman, director of Department of Social Security of the AFL-CIO; Mr. Josiah Beeman, director of political and legislative affairs of the American Federation of State, County, and Municipal Employees; Mr. J. M. Twomey, executive vice president of the National Association of Postal Supervisors; and, Mr. Dick Warden, legislative director of the United Auto Workers.

Gentlemen, we are extremely glad to have you with us. I note that you have sent forward extensive testimony. We are eager to have your observations and to have an opportunity to discuss this issue with you.

Shall we begin then with Mr. McGlotten.

STATEMENT OF BERT SEIDMAN, DIRECTOR, DEPARTMENT OF SOCIAL SECURITY, AFL-CIO, ACCOMPANIED BY ROBERT McGLOTTEN, ASSOCIATE DIRECTOR, DEPARTMENT OF LEGISLATION

Mr. SEIDMAN. Mr. Chairman, my name is Bert Seidman. I am the director of the Social Security Department of the AFL-CIO; with me, to my right, is Robert McGlotten, associate director of our Legislative Department. I will summarize my statement, but I respectfully request that my full statement be included in the record.

Senator ARMSTRONG. Of course, it will be.

Mr. SEIDMAN. Mr. Chairman, we appreciate the opportunity to present our views on the financing of the social security program. Public discussion on social security financing is both necessary and helpful. But we do not accept the unfounded allegations that the system is bankrupt now or will be in the future. The latest social security trustees reports add little to facts already known.

The AFL-CIO has been well aware of this situation and has repeatedly urged actions to deal with these problems. We do so again today.

The trustees emphasize that the trust fund situation will remain unsatisfactory for the next 5 to 10 years. But fail to emphasize that the situation will then improve and remain favorable into the next century.

While short-term cash-flow problems require attention and solution, there is no need to reduce any benefits. There are alternatives to the administration's massive program reductions. We recommend financing 50 percent of part A of medicare out of general revenues; and transferring one-half of the medicare tax to the OASI trust fund.

This action would finance the various social security programs well into the next century.

In addition to 50 percent financing of medicare from general revenues, we urge the following backup actions:

One, reallocate a portion of the tax rates now earmarked for the Disability and Hospital Insurance Trust Funds to the OASI program.

Two, authorize interfund borrowing to provide flexibility and back-up in the event the reallocation is not sufficient.

Three, insulate social security from the effects of recessions by authorizing the use of general revenue to shore up the social security trust funds during recessions. President Carter made this proposal in 1977.

Four, put into the social security law a provision stating that social security benefits, like interest on the national debt, will be paid from general revenues in the event payroll taxes are insufficient. A similar provision, the so-called Vandenburgh provision actually was part of the Social Security Act from 1944 to 1950.

These suggestions probably would resolve the long-range financing problem. But there is no pressing need to deal definitively with this problem until the many variables can be judged with a greater degree of certainty.

If it were thought important to show an exact 75-year actuarial balance, one possibility would be to set a tax rate in the next century that would fully finance the program in the long-run, but with the understanding that such a tax rate based on so many dubious and volatile assumptions would undoubtedly have to be adjusted at some future time.

Mr. Chairman, we are deeply concerned about proposals which have been advanced under the guise of dealing with social security's financing problems which go far beyond legitimate concerns about the program's financing.

The most recent example is the Reagan administration's proposed slashes in social security protections. None of these cuts are necessary. Under the proposal, early retirement benefits are cut by as much as 43 percent, the disability program by one-third. The 21 to 23 percent cut in overall benefits creates an actuarial surplus much larger than needed to balance the system for the next 75 years.

The objective seems to be benefit cuts, rather than sound financing of the system. The cornerstone of these proposals is the cutback in early retirement benefits. The Reagan plan would cut early retirement benefits to below 50 percent of the full benefit with the result that no retiree at age 62 in it in 1982 could receive a benefit as high as the official poverty threshold.

Hitting early retirees again, the administration proposes to cut the overall disability program by one-third. Even though 80 percent of those who apply for disability benefits, and are denied eligibility, are never able to work regularly again.

Mr. Chairman, the AFL-CIO opposes all proposals that would raise the age of retirement, increase the actuarial reduction, or in any way tamper with the early retirement provisions of the law.

We also strongly oppose the administration's proposal to reduce future benefits an average of 10 percent by a technical change in the computation formula during the next 5 years.

Another punitive proposal would eliminate the so-called windfall benefits which rightfully accrue under current law to Federal, State, and local retirees who qualify for social security from other employment.

In addition, the Reagan administration would postpone the 1982 cost of living increase for all social security beneficiaries, extend the disability maximum family benefit to retirement and survivors cases, eliminate children's benefits in early retirement cases, and apply the payroll tax to the first 6 months of sick pay. These are all objectionable proposals.

We also oppose proposals that would modify the social security cost of living formula on a mistaken assumption that retirees are overcompensated by the present CPI.

The administration's proposal to phase out the retirement test would come at the expense of benefits for the large majority of beneficiaries who are unable to work because of poor health or lack of employment opportunities. In total, these proposals represent a massive assault on the social security program.

The argument is made by the administration and others that these major program cuts are necessary because of the growing burden of older people. Those making this argument neglect to mention that a lower birth rate will mean a proportionately smaller labor force, but also, fewer children, unemployed and disabled.

Lower expenditures for these groups can be used to support retirees.

The best way to do this is to tap general revenues to help finance the system.

We warn that because the administration's proposals are so extreme, it may increase the willingness of some Members of Congress and some other Americans to accept major program cuts that are somewhat less drastic than the administration's recommendations.

It would be a disaster if this were to happen. Yet the many unfortunate proposals now pending in Congress which, if enacted, would greatly lessen long-standing social security protections give evidence that this strategy has been much too successful.

Mr. Chairman, the AFL-CIO recognizes the need for strengthening the financing of the program. There are effective ways to fully finance the program without slashing benefits.

We pledge to you our support and guarantee that we will play a constructive role in placing the social security system on a sound financial basis.

Senator **Armstrong**. Thank you very much.

May we hear from Mr. Beeman.

STATEMENT OF MR. JOSIAH BEEMAN, DIRECTOR OF POLITICAL AND LEGISLATIVE AFFAIRS, AMERICAN FEDERATION OF STATE, COUNTY, AND MUNICIPAL EMPLOYEES

Mr. **Beeman**. Mr. Chairman, distingushed members of the subcommittee, we appreciate the opportunity to appear before you today on behalf of the American Federation of State, County and Municipal Employees [AFSCME]. I am Josiah Beeman, political and legislative director for AFSCME, and I am accompanied by Charles M. Loveless, AFSCME's counsel for employee benefits.

Given the campaign mounted by the administration around the recently released report of the Social Security Trustees, I would like to submit our written statement for the record.

Senator **Armstrong**. That is agreeable.

Mr. **Beeman**. Mr. Chairman, it is clear based on recent economic projections that some action must be taken this year to address at least the short-term and hopefully the long-term financial problems of the social security system. However, we believe that the administration has greatly exaggerated the dimensions of the system's financial problems and is using social security's temporary cashflow problems to make permanent punitive cuts in the program's benefit structure, and to finance its huge cuts in the personal and corporate income tax.

In testimony before your subcommittee on Tuesday, Secretary Schweiker conceded that the administration was using worst case economic assumptions in calculating the projected revenue short fall in the system. At the same time, the administration is using much more optimistic as inflation and unemployment projections to justify its tax cut and defense spending policies.

According to the administration's own estimates, which some believe understate the magnitude of the savings from the cuts, the administration's social security benefit reduction proposals would save $46 billion over the next 5 years.

However, if more moderate and realistic economic assumptions are used, social security will require only $10 billion during the next 5 years assuming the interfund borrowing proposal is adopted. The administration's proposal, unfortunately, reflects the same biases that have motivated their entire economic recovery packet.

The program is skewed, so as to penalize low and moderate income workers while increasing the benefits for higher income individuals.

One of the groups that is singled out for a large share of the cuts are early retirees. These individuals tend to be concentrated in occupations that require physical labor and pay low or moderate wages.

Labor Department and Social Security studies indicate that the great majority of early retirees do not retire voluntarily, but do so because of poor health or unemployment.

While these cuts are being put forward, the administration is proposing elimination of the earnings test for all individuals over the age of 65.

It should be noted that the prime beneficiary of the administration's proposal of eliminating the earnings test would be individuals concentrated at the higher end of the income brackets who do not rely on social security as the primary source of income.

Approximately 67 percent of the new or increased benefits resulting from this proposal could go to persons with earned incomes of $17,500 or over. A group which comprises roughly 6 percent of the total OASI population age 65 to 68.

Once again, we are sorry to say the effect of the administration's proposal is to make the poor poorer and the rich richer.

On February 18, announcing his program of budget and tax cuts, President Reagan said, "The U.S. economy faces no insurmountable barrier to sustained growth." The President's optimism made many Americans believe in his program.

It is ironic that only 4 months later the President has adopted a pessimistic perspective on the American economy when it comes to our ability to fulfill our obligations to our senior citizens.

We believe that we face no insurmountable barriers to providing a reasonable and decent level of retirement income to our retired workers.

Other nations, some with fewer economic resources than our own, provide retirement income which put our benefit levels to shame.

The reason these countries can provide their senior citizens with a decent level of income is that they frequently use general revenues as a significant source of financing their systems.

Partial general revenue financing was contemplated by the architects of the social security program, by numerous social security advisory councils, and most recently by Congressmen Conable and Pickle, who have introduced legislation which would finance half of the hospital insurance program with general tax revenues.

If such a proposal were enacted, we could fund the current benefit levels without any increase in payroll taxes.

Mr. Chairman, I know that some Members of Congress are opposed to using general revenue funds because they believe such a change would enlarge the deficit. However, that need not be the case.

For instance, if the administration trimmed back its tax bill to limit benefits to upper-income individuals, it could maintain the solvency of the trust funds and not add a single cent to the deficit. We have calculated that if the tax reduction going to families with incomes of $50,000 a year or more was limited to the reduction now scheduled for those earning $50,000 a year, we could continue the current level of benefits, maintain the solvency of the trust funds, and have money left over to help reduce the deficit.

Given this fact, we can only assume that this administration is more concerned about reducing taxes for the rich than maintaining social security benefits for retired workers and dependents.

Thank you for the opportunity to present our views on this matter which are of utmost concern not only to our members, but to all Americans.

Senator ARMSTRONG. Thank you, sir.

Next is Mr. M. J. Twomey of Postal Supervisors.

STATEMENT OF MR. M. J. TWOMEY, EXECUTIVE VICE PRESIDENT, NATIONAL ASSOCIATION OF POSTAL SUPERVISORS

Mr. TWOMEY. My name is Maurice J. Twomey and I am the executive vice president of the National Association of Postal Supervisors, an organization representing over 33,000 management employees of the U.S. Postal Service.

I also have with me today Andrew E. Ruddock, a former Director of the Bureau of Retirement, Insurance and Occupational Health of the U.S. Civil Service Commission, who is now a consultant to our organization.

Mr. Chairman, we appreciate this opportunity to give the subcommittee some of our views concerning financing options for the social security system. For brevity's sake, I will highlight my testimony; and I would appreciate if our testimony was submitted for the record.

Senator ARMSTRONG. Thank you.

Mr. TWOMEY. We strongly urge this subcommittee to reject any proposal that social security coverage be made mandatory for Federal and postal employees. It is now generally recognized that imposing such coverage would not cure the financing problems of social security. But, it would be extremely disruptive to the Civil Service Retirement System.

Any immediate improvement in social security financing would be offset in future years as more and more public employees qualified for old age and other benefits. Even the short-range improvement would come in large part from general revenues used to pay the employer's share of FICA taxes for Government employees.

The true costs of any retirement system are measured by dollars actually paid out in benefits, plus administrative costs that are usually negligible. If Federal and postal employees were brought under social security, and the Civil Service Retirement System modified so that combined benefits from the two systems were about equal to present CSR benefits, there would be no savings. The sources of income and the funds used to pay benefits might be rearranged, but over the long term, the totals would be the same.

For the record, let me state that the National Association of Postal Supervisors is unalterably opposed to mandatory social security coverage for Federal and postal employees.

We believe it would be a serious mistake to legislate major reductions in benefits as a means of improving social security financing. In our opinion, a great majority of Americans would prefer some increase in taxes rather than the elimination, postponement or reduction of benefits.

In the final analysis, the soundness of the social security system depends on the willingness of each generation of workers to be taxed in amounts necessary to pay the retirement benefits of the preceding generation.

This willingness to be taxed stems, in large measure, from each worker having confidence that when it comes his or her turn to retire, benefits will be paid as promised by the laws under which he or she worked and paid taxes.

Any major deliberalization of benefits for the present generation would gravely undermine this confidence. The next generation would have to anticipate the possibility of similar or even greater deliberalizations in the future.

No one could make retirement plans with any certainty that benefits would be available at the expected time or the planned amounts.

There is at least one other way the willingness of Americans to pay social security taxes at necessary rates could be diminished. This could happen if the financing measures either increase taxes or reduce benefits or both, or to go beyond what was absolutely necessary to meet immediate financing needs.

This would create an impression that they were being adopted primarily to help balance the Federal budget. The temptation to distort social security financing for this purpose is very great since for every dollar for which social security revenues exceeded outlays, there would be a corresponding reduction in the budget deficit.

We believe it would be a great mistake to approve wholesale reductions in benefits for the purpose of balancing the budget. If that course of action were followed now, no generation of workers could have confidence that it would not happen again and again in the future. If the subcommittee decides to consider reductions in benefits, we suggest that it be done in ways that will minimize the adverse impact on individuals.

Effective dates should be set far enough in the future so workers can adjust their plans to avoid inconvenience and financial hardship.

Deliberalizations, if unavoidable, should apply only to the future service. It is most unfair to share the rules and pay lesser benefits than those that were promised by law during the period of which the work was performed and the taxes paid.

Above all, we urge the subcommittee to reject any options that would discriminate unfairly against Federal and postal employees.

Mr. Chairman, we thank you for this opportunity to express our thoughts on this subject, and we would welcome any questions.

Senator ARMSTRONG. Thank you, Mr. Twomey.

Mr. Dick Warden of UAW.

STATEMENT OF DICK WARDEN, LEGISLATIVE DIRECTOR, UNITED AUTO WORKERS

Mr. WARDEN. Thank you, Mr. Chairman, members of the subcommittee, I am delighted to be here this morning.

My name is Dick Warden. I am the legislative director of the United Auto Workers. I am pleased to be here to share with you briefly the views of the UAW on the current state of the social security system, and the Reagan administration proposal to deal with financing of the system.

Protection of the social security system, and those who benefit, as well as those who contribute remains one of the highest legislative priorities of our union and its active and retired members. We ask that our prepared statement be filed in its entirety for the hearing record, and I will summarize its contents.

At the outset, I wish to express the regret of UAW President Douglas Fraser who is unable to be here this morning. He is chairing a meeting of our international executive board today. If this prior commitment had not been scheduled, we would have requested time for President Fraser to testify on the vitally important issues before this subcommittee.

We will be pleased to respond to any questions you or other members of the subcommittee have about the contents of our prepared statement. And as I said, in order to avoid being repetitious, I will summarize what is in our prepared statement.

At the outset, I wish to say that we would like to associate ourselves in large part with the testimony of both the AFL-CIO and AFSCME which has preceded us.

I think the most important point to be made in beginning, is that even without the changes in benefit or aggregate tax rate provisions of the present law, the cash flow shortfall which the trust funds face in the next few years is only a temporary problem.

The near-term can be handled by interfund borrowing and relatively short-term loans from general revenue sources, or through amounts of general revenue financing.

Although the OASI fund faces more substantial deficits, than do the combined assets, the overall OASDI funds experience is the proper basis for evaluating the financial health of the system.

When the three funds are looked at together, it is clear that the situation is not one of great difficulty. As has been pointed out by the CBO, the system's cash flow problems can be handled with less than $10 billion of outside money. We are pleased that this point was made earlier this week when Secretary Schweiker testified before this subcommittee, by some of the members of this subcommittee—most notably Senator Moynihan. We agreed with very much of what Senator Moynihan had to say on that point.

We endorse the House proposal to finance half of the health insurance program from general revenues. And to shift half of the present health insurance premium to the OASI program. In short, we believe the current crisis can be resolved with minimal impact. The dire warnings that social security is, as some people have alleged, teetering on the edge of bankruptcy, neglect to point that the problem is a temporary cash flow one, centered in the OASI trust fund which can be handled with relatively modest financial provisions.

With respect to the longer term, the financial status of the social security system can be improved by phasing in general revenue contributions which might ultimately provide as much as one-third of the financing.

In addition, the maximum taxable wage base should increase beyond the levels provided by current law to provide additional and more equitable financing.

We do not share the pessimistic outlook that our Nation's economy in the 21st century will be unable to support the current retirement age formula.

Progress over the next 50 years can easily be as great—more likely will surpass—progress during the past 50 years.

The point of all of this, which again must be emphasized, is that the problems have been blown out of proportion. We believe they are manageable and can be solved in a much more humane way than the administration would have us believe.

In general, the administration's proposals introduced a new degree of uncertainty regarding the reliability of social security benefit commitments. In that connection, I would like to commend the testimony of one of your witnesses earlier today. From having answered the telephone and been out in the last week or so with our members around the country, I can assure you that what she says is true.

Senator MOYNIHAN. You mean Dr. Butler?

Mr. WARDEN. Yes.

The uncertainties that have been created by the things that have been said about the financial condition of the system, we don't believe that that has been helpful at all.

As a matter of fact, we think that is having a counterproductive effect, and we hope that this subcommittee will do some things to counteract some of that negative message.

We believe the administration's proposals have introduced a new degree of uncertainty, coupled with the trustees' report released this week, regarding the reliability of social security benefit commitments.

Prior to the presentation of those proposals, there had been considerable well-founded discussion of the short-term problems and the longer-term changes which need to be addressed with respect to social security. While there is considerable difference of opinion as to the appropriate actions that should be taken, practically all knowledgeable persons who have studied the system, have agreed that solutions are available which are consistent with the American people's rightful expectation that they can plan their future with continued confidence in the social compact which has been embodied in the social security system.

The administration's proposals departed from this premise. Their propoal on early retirement benefits, for example would be unnecessary even if it had been put forth on a longer-term basis and is unjustifiable as a near-term action.

Congress has already repudiated this proposal to change the rules in mid-game for those workers who have already left their jobs, but are not yet age 62. And for those who otherwise would start collecting social security before age 65 in the near future.

However, it is important that the debate not be narrowed to when such a change would take place, the real issue is whether it should occur.

Of course, on that point, we don't think it should occur. The proposed cut in replacement rates by curtailing the so-called bend point increases is simply an effort to reduce the value of social security benefits to all future retirees. Current replacement rates, in our judgment, are not excessive. They were established by Congress in 1977 after long study. In fact, we believe they are too low. Any analysis of retiree income needs, rather than of arbitrary cuts in budget levels for social programs, clearly argues against reducing social security.

It is ironic that the administration includes the very expensive proposal along with its other proposals to phase out the retirement earnings test for anyone over age 65. That would primarily benefit higher paid persons rather than the bulk of the American people who struggle to make ends meet.

It is simply ridiculous, in our judgment, to argue that the Nation cannot afford to provide even inadequate retirement benefits to those who need them most. And, at the same time, to propose that anyone over age 65 should be able to earn as much as they want and continue to draw social security.

The retirement earnings test serves a valid purpose in distinguishing who is in or out of the work force and should be retained with appropriate updating, such as is already provided in the law.

Our prepared statement summarizes our reactions in general to the major proposals in the administration's package. Lack of comment upon others does not indicate lack of objection.

We are concerned about using social security cuts to balance the budget. The simple fact is that the President's proposals provide much greater financial impact than is needed. Spokesmen within the administration themselves have admitted that the long-term cost impact of these proposals would be twice the usual estimated actuarial deficit.

Over the next 5 years, the disparity is even greater. In fact, if interfund borrowing were allowed, the trust fund as a whole, would experience a short-fall of only about $10 billion during all of the 1980's. Yet the administration's proposals would cut benefits by $82 billion over the next 5 years.

The additional $70 billion plus becomes part of the administration's plan, we assume, to balance the budget. We think there is a more sensible method of reaching that goal.

As President Fraser said this week, earlier this week, in reacting to the trustees' report, the administration appears to project a worse case scenario when it predicts that the old age fund will run dry next year. That prediction is contradictory to the administration's claim that its budget and tax proposals will increase employment and decrease inflation.

Higher employment, and lower inflation, would help prevent the funds exhaustion.

So it is a case of which of the administration's predictions can be believed. I think this is a point that was very well made this week by Senator Moynihan when Secretary Schweiker testified.

There are short-term problems, and we recognize them. But they involve temporary cashflow difficulties, largely due to the recent high inflation and unemployment, but aggravated by the maintenance of three separate trust funds within the system.

Interfund borrowing plus modest general revenue financing and/or outside borrowing could take care of any difficulties that can reasonably be anticipated during the remainder of this century.

The short-term problems do not and cannot justify imposing a penalty on current or future retirees.

Even under the present benefit structure, social security payments for many years will be a smaller proportion of GNP than they now are.

The longer term costs will have to be corrected. That cost will be manageable in an economy that undoubtedly will provide higher real income per capita than we now have and which probably will not suffer from other more difficult population problems such as overcrowding.

Providing a decent retirement income for older Americans will not impose a difficult burden on the economy. Thus the focus should be on how the system will be equitably and adequately funded, including sources other than the payroll tax, rather than reducing benefit entitlements.

Mr. Chairman, members of the subcommittee, I appreciate very much having the opportunity to be here this morning and to share with you the views of the UAW on this important issue. Thank you very much.

Senator ARMSTRONG. Thank you, Mr. Warden.

Senator Durenberger, do you have questions for the panel?

Senator DURENBERGER. Let me start with a question relative to the health insurance that I think you have heard me raise before with other witnesses during the course of this week. And, I have heard several endorsements of the House approach which is to take half of it out of general revenue.

Can I get a general reaction from all of you in terms of the appropriateness of using the payroll tax to fund the noncash portions of social security?

Mr. SEIDMAN. If I may lead off. We think that it is important to retain the payroll as a major source of funding of the entire social security system, including medicare.

We are advocating now that a portion of medicare be paid out of general revenue.

We have long advocated, as has already been mentioned, the fathers of this system advocated, that a portion of the entire social security system should be paid out of general revenue.

For us, it is somewhat of a bookkeeping matter as to whether it goes into one program or another. But if there is support for whatever reason for focusing general revenue of the medicare program, rather than the rest of the program, we support that approach. And, therefore, at the present time, we are favoring the approach which Congress Pickle and Congressman Conable have recommended to the House of Representatives.

Senator DURENBERGER. Other reactions?

Mr. BEEMAN. Yes, Senator, we would subscribe to that statement as well. It does occur though, to us, that if there were interfund borrowing or perhaps, indeed, ultimately even a merger of the three funds, that you would then have a system which is partially or in whole funded at least with health insurance out of general revenues. That seems to be very much the direction in which we think the system should be going.

Senator Durenberger. Mo.

Mr. Twomey. Senator, yes, we concur with your views on that. But we feel very strongly that the medicare should not be connected with the FEHB as the Senate took action recently. But, we do concur with your statement on payroll tax.

Senator Durenberger. The portion of your statement that you weren't able to read, deals with the whole issue of the relativity between FEHB, insurance, and medicare.

I think I read the statement to caution us against being discriminatory in some way, not necessarily that Federal employees or postal employees would object to making medicare a secondary payer if all other employment in this country were arranged in a similar fashion.

Is that correct?

Mr. Twomey. That is correct.

Senator Durenberger. Thank you.

Senator Armstrong. Senator Dole.

Senator Dole. If I understand correctly, it's generally agreed by members of this panel that we should not make any changes in benefits. Is that an accurate reflection of your views?

Mr. Twomey. That's correct.

Senator Dole. Any changes we make should be financed by general revenues?

Mr. Warden. Senator, general revenues, interfund borrowing and the other suggestions that we have made in our testimony.

We believe that that will cover it, yes.

Mr. Seidman. Or also, perhaps, Senator, short-term borrowing from the Treasury as well.

Mr. Warden. Yes.

Senator Dole. You also indicate that you would oppose any efforts to tighten eligibility for disability insurance benefits. We are not talking about affecting anybody presently receiving disability benefits, but we are talking about future beneficiaries.

You don't suggest that there is anything we could do to tighten up that program?

Mr. Seidman. I would like to point out to begin with, that the disability insurance program is primarily a program which involves older workers. I don't remember the exact figures, but is something like 75 percent of those who are receiving disability insurance are over the age of 50 and a very large proportion are over the age of 55.

These are workers who are unable to work. And many of them are now being denied eligibility for disability insurance despite the fact that their disability makes it impossible for them to obtain any employment.

The proposals that the administration has made, I won't go into the details, but they would very much tighten this. They would affect particularly people with dibilitating diseases. Those people who gradually are unable to work, are in and out of the labor force, and the proposed restrictions would mean that those people—at the point where they would finally be medically eligible for disability insurance—wouldn't have enough quarters to be eligible.

So, we are very much opposed to these proposals for restricting eligibility for disability insurance.

Senator **Dole**. As far as you are concerned . . .

Mr. **Seidman**. They would be aimed at a very, very defenseless group.

Senator **Dole**. That may be generally true, but there have got to be some who shouldn't be receiving benefits under that program.

Mr. **Beeman**. Well, Senator, I think it is worth noting that the number of disability benefit awards has been declining steadily since 1976. The number of awards dropped from in 1975 from 592,000 to 390,000 in 1980. Prior to the passage of H.R. 3236. So, there is apparently already a downward direction due to the tightening which took place in that legislation. The question is whether or not the Congress is interested in turning the screw as it were on those people tighter than it needs to be, given the present trend and the present status of the DI fund.

Senator **Dole**. I don't suggest we are interested in turning the screw, but we are interested in saving the system. We are going to have to find some way to do it. You don't proposed we do anything except take it out of general revenues which impacts all the American people. Raising taxes in that fashion doesn't seem to me to be a responsible approach to solving either the short- or the long-term problem.

I agree that we could do some interfund borrowing. I am not as optimistic as Mr. Ball and others who feel that we really don't have a problem.

I don't believe that this Congress will support a social security tax increase. You don't suggest an increase in taxes, do you?

Mr. **Seidman**. No, we are not proposing an increase in taxes. We are proposing, as we have indicated, that we think that general revenues should be used for this purpose.

All of us support an entirely different approach to tax policy than the one that has been recommended by the administration. A number of witnesses have indicated that.

I should add to this that none of us here, and I know Mr. Ball very well, and I don't think he has said that there is not a problem. He has said that there are manageable ways of dealing with the problems which do not involve cuts in social security benefits. And, that's what we are saying.

We do not say that there is no problem. To the contrary. The statement of each of us has indicated that there is.

Senator **Dole**. I don't suggest that. But I do suggest that you would address the problem by moneys from general revenues.

Just one final question. Do you all support removing the earnings limitation?

Mr. **Seidman**. We're—I can only speak for myself at the moment. I don't know what the others would say, but our position is that we would keep the earnings limitation as it is. The administration has proposed removing it at a cost of $6 billion. That $6 billion would either deplete the trust fund and also would be at the expense of people who can no longer afford to work, paying full benefits to people who can continue to work.

Senator Dole. Is that the view of——

Mr. Warden. Senator Dole, speaking for the UAW, I concur with what Bert said. And, as I pointed out in our statement, we believe that there is an anomaly in saying that this Nation can't afford what we believe already to be inadequate social security benefits. And then maintaining that the retirement test should be removed. And that people over 65 should be allowed to draw their social security benefits and continue to work.

We just believe that the retirement test is a good thing.

With respect, Senator Dole, to the disability insurance point that you made, I really don't believe that the administration has had time yet to evaluate the changes that were made in the last Congress.

As I think has been pointed out, there has been a decline in the number of applications, claims that are being approved, and I think that that reflects the changes that the Congress made over the period of the last 2 years. I don't think there has been adequate time to evaluate really the full impact of those changes.

Senator Dole. My time has expired.

Mr. Beeman. I just wanted to say, Senator, that 67 percent of the benefits under the earnings test would go to persons making over $17,500 a year, who are only 6 percent of the OASI recipients age 65 to 68. So to make that kind of expenditure, and then upon committing reduction in benefits of those who need it most, just seems to be an upside down priority.

Senator Dole. Thank you very much.

Senator Armstrong. Mr. Moynihan.

Senator Moynihan. I would like make a point about the disability program and proposed changes in it.

We heard good testimony yesterday about the nature of chronic disease, the onset of which is slow and intermittent. And, I resist the idea that the disability program should be curtailed. It is actually those with chronic diseases who are not protected under our present arrangement.

At the present time, 70 percent of the people who apply for disability benefits are rejected. And of those rejected, 80 percent never work again—they are disabled.

Now, that's quite a disability system—if you are disabled, you may very well not qualify.

I would like to make one point, then ask a question. What I would like to say was very clearly emphasized by Mr. McGlotten and by Mr. Warden. Which is that after a week that started out with a clear effort to stampede this committee—we have seen the public panic. Older people around this country don't understand the fine points, don't know who the trustees are and don't know what the actuarial projections are. And the administration has succeeding in terrifying them.

We have established, as you said, Mr. McGlotten, as Mr. Myers testified and as the Chairman just suggested that we have a near-term deficit that with interfund borrowing, might be in the area of $10 billion over the next decade. Which could be borrowed or transferred from general revenues.

We already pay doctor bills under the S.M.I. trust fund from general revenues. There is no large ideological barrier to using general revenue for social security. The administration's proposals would cut benefits by $82 billion in the next 5 years to meet a shortage that might be as much as $5 billion. There can be no justification of that in terms of the social security system. Unless they want to punish people who retire at 62—most who do so are ill—and reward people who don't retire because they are affluent.

They are trying to get money to offset other shortfalls. I don't blame them for trying. It will be our fault for letting them succeed.

I think that matter is settled.

Mr. Myers, my very distinguished friend, testified that over the long-term that we have talked about, the administration proposals would bring in twice the payroll shortfall.

Why is this? To me the answer is completely obvious. But I would like to ask this panel a different but related question. Mr. McGlotten, perhaps you are best able to answer it.

Negotiations on trade union pension funds assume a certain level of social security will be part of the worker's retirement benefit. If social security is squashed, will you have to go back to the bargaining table and get higher retirement benefits out of the private employers of the country? Aren't you going to have to do that, sir?

Mr. McGlotten. Most definitely, Senator. We would have to do that. Dick Warden has, all of his contracts 30 and out. Many of our contract within, depending on the sector, have different kinds, but Dick can speak to this issue.

Senator Moynihan. Mr. Warden?

Mr. Warden. Yes, thank you, Senator. The UAW does have a program that is commonly referred to as 30 and out. In other words, if a worker has 30 years on the job and he wishes to retire before he reaches age 65, we have bargained collectively for those people. So they retire at age 56 after having worked 30 years in the plant. So that they are receiving let's say $1,000 a month when they go out.

That is predicated on the assumption that there is going to be a certain early retirement social security benefit available at age 62.

Senator Moynihan. Which the administration would cut by 40 percent.

Mr. Warden. Yes, that's right. And for individual UAW retirees we have estimated that can result or could result if the administration proposal were adopted, of a loss of as much as $300 a month.

Well, $300 a month for a person who is on a retirement benefit of $1,000 a month is a pretty significant share.

So it is not only devastating in terms of retirees after they reach age 62 but it is devastating to international unions, and the UAW's only one of them, where we have negotiated on the assumption that early retirement benefits were going to be available. And, then if they are slashed, as you suggest Senator Moynihan, you have to go back to the bargaining table and reopen those negotiations.

Senator Moynihan. Employers all over the country are going to be told we have to renegotiate and you are going to have to put up if we are going to keep the level of benefits to which we have agreed. I assume this will have to be coming out of the firm's income.

Mr. Warden. Absolutely.

Mr. **Seidman**. I would just like to point out, Senator, I agree with everything that Dick Warden has said; but I would like to point out that this applies not just to the administration's restrictions, proposals, to drastically limit the early retirement benefits but to all of the proposals for cutbacks in social security benefits.

The disability programs that have been collectively bargained assume that there will be a certain level of disability insurance.

The so-called change in the bend points which is going to reduce the benefits of everybody in the future will obviously become a matter for collective bargaining.

Unions will do whatever they can to make sure that if these reductions in social security benefits take place, and we hope they don't, that they will be made up in the private pension system. And, that, of course, means that they will be paid for by employers. Because in practically all of our pension programs, are so-called noncontributory programs.

Senator **Moynihan**. Mr. Chairman, if I could take just one more moment because this panel represents American workers and the largest group of people to come before us. I wonder if I could ask Mr. Beeman, would there not be many situations in which State and local governments will have that same experience where pension plans assume social security benefits at the established rate. Now the administration proposes to take them out. Wouldn't you have to renegotiate?

Mr. **Beeman**. Yes, that's very much true, Senator. That in many States, the public employee pension systems and in local government levels are composed of, and the pension rate is set depending upon the amount of the social security benefit that would be derived.

If the social security benefits were reduced, then the cost to State and local government pensions could also go up, increasing already the exposure and underfunding that already exists in many jurisdictions. And a resultant tax increase or other revenues required to redress the shortfall that would be caused by a reduction in the social security benefit.

So, it would set off a chain reaction across the entire United States at the State and local government level where approximately 70 percent of those employees are in pension systems that include a social security and are covered under social security.

Senator **Moynihan**. That would have been my judgment. I thank the panel very much for confirming a very important point. If you want to have every collective bargaining contract in this country reopened, follow the administration's proposals. But we aren't going to do that. They will not pass.

Senator **Armstrong**. Very soothing, Senator.

Mr. Long, did you have anything?

Senator **Long**. Mr. Seidman, I take it your views are pretty much similar to those of Mr. Ball, who testified yesterday. Are your views on this matter pretty close to his?

Mr. **Seidman**. They are. We are, he spoke for a coalition called Save Our Security. The AFL-CIO is one of the groups which is in that coalition.

Senator **Long**. I have always taken the view that I don't want to agree to finance social security out of general revenues because in the last analysis, that's nothing but a commitment to finance social security out of a deficit. At least that's how it would seem to me. It would just create social security benefits out of printing press money.

If we are not raising enough in taxes to pay for the social security program, then I think that your suggestion about paying for half or even paying for all of medicare out of general revenues would solve the problem, or at least solve the problem between now and the year 2000 or 2010.

Is it your opinion that that would or would not solve the problem?

Mr. SEIDMAN. We think that it would solve the problem well into the 21st century. By which time we will have a much better idea of whether or not these very alarming charts do or do not represent the situation at that time.

Depending on what assumptions you make, the further out into time that you go, the more that you are compounding whatever that assumption is.

Senator LONG. You might have seen me smiling before. But I wasn't smiling at anything that any witness said on this panel. I was just looking at that chart over there that shows social security benefits as a percent of payroll costs, and the line runs off the chart in the year 2050 at 48 percent of payroll.

I was looking at that thing and thinking well, it looks like that's about when the world comes to an end. I would have go on ahead anyway, and those who are around here let's say in the year 2020 can struggle with the problem between then and the year 2050.

It would seem to me as though we could keep things in pretty good shape up to about the year 2020, and that will leave plenty of time for some other people to come along and find some other answers between now and then.

I do think that we ought to try to get the word out to old people that the world will not come to an end between now and the year 2000. It looks like we are going to hold out that long.

Mr. SEIDMAN. We are trying to do that in every way we can. And every time we think that we have got the message out, then we get the kind of announcements that we now expect to get from the administration from time to time which raises all the fears all over again.

Senator LONG. Well, if the administration hadn't heard about it, I would urge them to start talking to some people just the ordinary course of life—the waiter that will serve you at any restaurant or private club that you might go to here in Washington, D.C., doorkeepers, night watchmen, or whatever.

I think you will find that all the old people are just scared. They are terribly upset about all this talk that their social security is not going to be paid.

Mr. SEIDMAN. I couldn't agree with you more, Senator. It is very frightening.

Senator LONG. I try to tell them, don't worry, we are not going to let that happen. Isn't it fair to say that the social security benefits will not come to an end until we have a Congress that wants to end the program?

Mr. **Seidman**. You are absolutely right, Senator. We have the confidence in the Congress that it will see to it that social security benefits are paid.

Senator **Long**. I don't think at this point, if we just took a poll, that you would find in the House or the Senate that there was a majority who would be willing to let the social security program come to an end.

We don't have any such Congress.

Is that how you would analyze it?

Mr. **Seidman**. We certainly do. And, that's our hope. We hope that that confidence is not misplaced.

Senator **Long**. Well, it looks to me as though there is a great deal more furor than the situation deserves.

There is no way you can be sure what the future holds. I thought when we voted for the social security financing bill in 1977 that we had taken care of the problem for many years to come. But who could tell that the ayatollah would come into power in Iran, shutting off all the oil supplies and doing some very stupid and unreasonable things that created problems for the whole wide world? Who could tell that there would be a recession that was not anticipated? Or about costs going up faster than wages went up?

There are all sorts of inponderables, but in the last analysis, it seems to me that as of now, it is well within our capabilities to fund this program.

Mr. **Beeman**. I think, Senator, I think that's the point. In other words that there is interfund borrowing that can be done to deal with the short-term problem. And, to test what the economic assumptions are going to be between now and the time that that appears to be the case. And, then if a more drastic remedy is required to make that drastic remedy at that time. But to make the drastic remedy at this time, on assumptions that are clearly in great dispute, would be a real disservice to the people, the poor people and the older people in the United States.

Senator **Long**. I don't think it would be drastic if we had medicare, for example, over general revenues. If we had to do it, I don't think there would be anything drastic about that.

Now, over and beyond that, do you see anything drastic that we would have to do in order to keep the program going from now until the turn of the century?

Mr. **Seidman**. We don't regard any of these recommendations as drastic at all. Interfund borrowing, for example, is just a bookkeeping proposal, that's all it is really. We have put a certain amount of money into these trust funds. For historical reasons, we have three instead of one. But it is all one program, and there is no reason why we shouldn't have this interfund borrowing.

Mr. **McGlotten**. Again, Senator, in 1977 the amendments which we worked very hard with you to take care of the problems. We sat down and we talked about a tax. We were talking about interfund borrowing at that particular time. But we said that because of the taxes, it wouldn't be needed.

One of the things that no one took into consideration was the fact after 1977 we have constantly had since 1977, almost 8 million unemployed who are not paying into the trust fund.

One of the things that we have to do is to take a look at the unemployment rates so that we also have some infusion of general funds so we won't face this problem into the year 2000.

Senator LONG. Thank you very much. I think I will sleep well tonight. I have heard about what I need to know. Thank you very much.

Senator ARMSTRONG. Thank you, Mr. Long. I am going to take time for my own questions—at least in part—to share a concern that maybe we are all sleeping a little too well.

Senator Long, and Senator Moynihan, and this particular panel of witnesses basically are taking a "Don't worry, things are going to pan out all right" sort of attitude. I just want to urge my colleagues not to get too deeply entrenched in the idea. That, somehow, Congress will take care of us. Because I remember some promises that Congress has previously made that haven't turned out very well, particularly promises made about what we would, or would not, let happen to the national economy, unemployment, inflation, and so on.

While I share your feelings that no Congress will willingly permit the default in the system, I don't automatically assume that we are going to forever have control over every aspect of the national economy if we fail to act with reasonable prudence now.

Then there is the argument which this panel has made, and which others have made, that, don't worry, the big problems don't come for a few years—maybe not even well into the next century.

I think we all understand that the largest dollar problem does arise in the next century. But if we wait until then to begin to take the steps necessary to head off the problem, then by its very nature, if the moderate or pessimistic projections turn out to be true, the solution at that point could not be a gradual one. I think there is a general agreement that the last thing we want is a drastic, immediate change in the economic arrangements in social security, that whatever changes you make, they should be quite gradual in nature.

Mr. SEIDMAN. That is why we are opposing the drastic, immediate changes which the administration has proposed. But may I say something about that?

Senator ARMSTRONG. You may in just a moment. I want to make one more point, and then I want to address a question to you and also to Mr. Warden.

The third reason why we are told that we don't need to worry about all of this is that after all, we can go to the general funds.

Gentlemen, that's pie in the sky. I am just going to tell you something. Your own members whom you are representing here today, in my judgment don't believe that. And I represent a lot of them too. I talk to them often. They don't think there is money in the general fund to finance any new programs.

In fact, out our way—I am only speaking to the people that I represent in Colorado—the thought that we can load up the general fund with any more new programs, is just anathema across the board because of the inflation that is engendered.

So, if you talk about loading the cost of these programs onto the general fund, I think it would be responsible to also say whether or not you are prepared to increase the taxes; or whether or not you are prepared to cut back in other programs. That is a point of view; it isn't mine, but it is certainly one that if you want to advocate, you can.

To just say we are going to put it on the general fund is a copout in my opinion.

I want to address a question actually not only to Mr. Warden and to you, Mr. Seidman, but also first, if I may, to Mr. Twomey.

You made the observation, if I may quote it directly from your testimony that, "the soundness of the social security system depends on the willingness of each generation of workers to be taxed in amounts necessary to pay retirement benefits of the preceding generation."

I agree with that. We have had testimony here this morning, and there is substantial evidence in public opinion polls, that in fact there is a breakdown in that willingness. I think the gentleman from Pennsylvania spoke to that point when referring to the bitterness of his 33-year-old worker. Senator Chiles yesterday referred to an intergovernmental time bomb. Public opinion polls have suggested that there is a real concern about that.

What is your own opinion? Given your view that the soundness of the system depends upon that consensus, do you feel that it is in good shape, that that concensus is solid and sound around the country?

Mr. Twomey. Are you asking is the social security system in good shape based on that?

Senator Armstrong. I was really asking whether or not you feel that the willingness of each generation remains beyond question? Or do you also sense that there is some concern on the part of younger workers as to the basic fairness of the system and their willingness to support it?

Mr. Twomey. Senator, I believe that you have a situation that is apparent with the times today. When you refer to young, are you referring to young in age, are you referring to young in service, are you referring to young in working class? I think there is a problem here that enters into it. Looking back, or thinking back to when I was a young man, I know the first 10 or 15 years that I worked, I could care less about a retirement or any other picture.

I think that pretty much is the sense of the young people today in the country. They are living for today, and the dollar they are earning today are for the things that they want today.

But then after they have vested 10 or 12 years or 15 years in a particular job or a particular craft or skill, suddenly they begin to think of their family. They begin to think of their future. They begin to think of what's going to happen the day when they retire.

In answer to your question, in this context in my traveling across the country, I find that the people talking to me are willing to pay to be sure that they have the benefits that they can look forward to and count on the day that they are looking to retire.

In answer to your question, the answer is yes.

Senator Armstrong. Thank you, I appreciate that.

Mr. Warden, you, I believe, carefully specified that the mere fact that you hadn't touched on every proposed change in the social security system, didn't indicate that you failed to object to them.

I want to ask this question. I think it is clear that you don't favor any reduction in current benefits.

Are there any proposals that have been advanced from any quarter whatsoever for a reduction in the rate of increase of future benefits which seem to you to be justified. Or are you just flatly opposed to any?

Mr. WARDEN. We are not in favor of reducing benefits now nor are we in favor or reducing benefits in the future.

If you have a specific proposal in mind we, of course, would like to take a look at it.

Senator ARMSTRONG. Well, there are about 2 dozen proposals, and they are somewhat beyond the scope of this hearing today. But we will be happy to furnish you with those propoals and be glad to have your comments on them.

The reason I raise this concern that obviously if we take a position that there can be no change even in the rate of increase in the future, then we have truly got an open-ended system that is ratcheted so that it can only go up and can't ever be adjusted to a slower rate of increase.

The impact on payroll or general fund is open-ended and it is a source of great concern. That's really what this social security cost as a percentage of payroll refers to. Obviously nobody thinks that the social security system would be permitted, even in the year 2050, to go up to 48 percent of payroll. [Indicating.]

I think, in fact, Senator Long asked about that earlier in the day. The point was that long before it got to that, some changes would have to be made.

Senator LONG. Senator, I take it if the world comes to an end long before the year 2050, that basically——

Senator ARMSTRONG. No, I don't think the world's going to come to an end. What I think will happen, and what we have had extensive testimony on both yesterday and early this morning, is that at some point the workers would be unwilling to bear that burden, and changes in the system would be made which would prevent the worst case assumptions on payroll from coming into being.

That is a view that I share. I don't think it is going to go to 48, 35 or 30 percent.

In fact, I think, personally, that the presently scheduled maximum of 15.4 percent is about as far as it is likely that any Congress will permit the payroll tax to rise in our lifetime. And probably as high as it should go.

But back to Mr. Warden. What is your view? Are there any changes in the benefits in your liability that you'd endorse?

Mr. WARDEN. Again, if you have something specific in mind, we would be happy to take a look at it.

We have not seen anything from the Reagan adminstration that we are enamored with, I can say that.

But, let me point out that in 1977 the Congress did cut benefits. You decoupled, for example, in the context of the 1977 act. The labor movement supported that. It was something that the Carter administration proposed; and the Congress enacted it.

So, it isn't true that the Congress has never done anything to reduce benefits.

Senator Armstrong. Well, gentlemen, I am grateful to you.

Mr. Seidman. May I just comment on the question of the 21st century, because I think it is very important.

Senator Armstrong. Of course.

Mr. Seidman. The chart that you have there relates to social security beneficiaries. And, they really are not beneficiaries, they are people over the age of 65 as I understand it.

Senator Armstrong. Which chart are we looking at?

Mr. Seidman. Who pays for social security? That's where the people feel that the problem arises.

I think that what we should be looking at is not just people over 65, but the people who are dependant on workers generally.

If you look at total dependency ratios—that is, the ratio of people over 65 or under 20. For every 100 people in the age range from 20 to 64, you will find that there were 95 such persons in 1965. It has been going down since then.

Senator Armstrong. 95 per——

Mr. Seidman. Per hundred in the age range of 20 to 64.

It has been going down since 1965; and in 1980, it is 75.

It goes down still further to the year 2010. In other words, the situation improves between now and the year 2010.

It begins to rise again at about that time, according to the best projections.

Even by the year 2035, it doesn't get back to the 95 level that it was in 1965.

Now surely, as a nation, if we are going to have—the reason for this is that as those over 65 increase, the number of children in proportion to the rest of the population declines.

Now surely, as a nation, we ought to be able to recognize the obligation that we have to older people if we have a lesser proportionately group of younger people that we have to take care of. And, even if it can't be done through a payroll tax, it certainly could be done through the use of general revenues in the social security system.

But it is simply a transfer of resources.

There are others ways of looking at it. You could look at it in terms of the percentage of the GNP. And, again, that percentage——

Senator Armstrong. That's the chart that Senator Moynihan provided, "Cash Benefits As A Percentage of GNP."

Mr. Seidman. Yes.

And, it doesn't begin to get above our present levels in the terms of the percentages. And then it goes down again.

But we have to bear in mind that what we are talking about is a much higher level of real wages at that time, when we have the higher the GNP.

Again, it seems to me that the economy ought to be able to meet the needs of older people. Particularly in light of the fact that these social security benefits may be going up as a percent of GNP. But the expenditures for the young will be going down at that time.

Senator Armstrong. I want to get back to Senator Durenberger who has one more matter. You make a very interesting point.

Mr. SEIDMAN. You may not have this acute problem in the 21st century that everybody's talking about.

Senator ARMSTRONG. You may be right, and I hope you are. However, I don't necessarily buy the notion that it's the same kind of either economic or social cost to support an elderly person in an independent life setting financed through an intergenerational tax transfer system, as it is to support children who customarily are not financed in that way and who live at home with their parents.

Mr. SEIDMAN. It will test our mettle, I agree. Because some of this involves private expenditures and some of it involves public expenditures. But I don't believe that the American people would want not to transfer those resources and have the older people—their parents, their grandparents, and themselves in their own imagination in the future—living in poverty.

Senator ARMSTRONG. Well, I think we can agree to that.

Senator Durenberger.

Senator DURENBERGER. Senator, I just want to make an observation without a question.

Bert talks about testing the mettle and you talked about the generational problem here and he talks about bookkeeping and you talk about charts. Senator Moynihan talked earlier about this panel as the one that represents the American worker. In a legalistic sense, they may represent something under 25 percent of American workers. I think everybody we have heard from today—and we are going to hear from today, represents the American worker.

The chart that ought to be up there is the chart called the employment tax. What is the tax on employment on jobs going to be in the future? We have a tax on employment called the payroll tax and you could add FUTA, State unemployment compensation, and workers compensation.

We have taxes on income called the income tax, called life insurance, health insurance, accident insurance, disability insurance, pension plans, vacation, sick leave, and so forth. And, I think that's what we are talking about. That is what all of these panelists are talking about.

Mr. SEIDMAN. If the tax proposals now under consideration in the Congress are adopted, there will be a very much larger percentage of those taxes paid by the very workers you are talking about; that's one reason we are opposed to those tax proposals.

Senator. DURENBERGER. Well, I think it is just important that all of us—understand that we are really talking about the future of employment in this country and who bears what burden for the consequences of employment.

Mr. SEIDMAN. Indeed we are, and that's one reason why we would not want the whole system to be paid out of payroll taxes which falls solely on a select group in the population. And, that more of the program should be paid for out of general revenues which would fall on the total population.

Senator DURENBERGER. But, it's a lot more than bookkeeping. That's my point.

Senator ARMSTRONG. Senator Durenberger, while you were speaking I went over and uncovered a chart which simply relates, at least in part, to the question you were asking.

You will note a very sharp rise in that graph which is not, as you might suspect, the projectory of the Space Shuttle; but is the projected increase in the social security tax. [Indicating.]

Not into the next century. Not to the year 2050 when the world will come to an end. Not the 2020 when revolution occurs, Senator Long. But in the year 1990 which is only a term or two down the road for Senators. [Laughter.]

That figure, you will note, rises very sharply; it is up around $9,000 per worker.

So the point that Senator Durenberger has made is a very significant development.

Gentlemen of the——

Senator LONG. I would like to go back to what the Senator said.

Let me just say that I can recall a time when this Nation was in bad shape. The chairman of this subcommittee seems to think we are in very bad shape now.

I don't happen to think so. It is all a relative matter.

I can recall when we were really in bad shape, when there were millions of able-bodied men wishing for nothing more than an honest chance to earn a dollar, standing in line for a handout where they could get it, private or public or any sort—about 25 percent of the whole work force was out of work.

This was back at the time before the Government was willing to accept the philosophy that this Government has a responsibility for its citizens' welfare. This was back before we had any public welfare programs, back before we had any social security program, back when the Government took the attitude that it was every man for himself, and the devil take the hindmost.

I don't happen to agree with that. I believe that together we are strong.

We have had a recession since that time, but no cruel Great Depression when nobody knew where he was going to turn to or who he was going to look to for help. I just don't agree with the prophets of doom or disaster who think that we are just going to come to an end because the people are not willing to pay a tax for the support of the aged, sick, and disabled people in America.

I don't think they have got the votes to kill social security, and I dare them to try it. It is just that simple.

Senator ARMSTRONG. Now you know, Senator, that nobody is talking about killing social security. There is a desire on the part of many of us to save it from its own excesses. The kind of a tax that we are projecting out here, in my judgment, comes very close to being excessive. You don't have to have a long memory, you don't have to remember back to the Great Depression, to recall a time when the after-tax, after-inflation income of American families was rising instead of declining, and when inflation was thought to be too high at 4 or 5 percent.

Now, the point you are making is not wrong. I don't disagree with that. But I think you will have to admit that if times have been worse in America's economic history, certainly times have also been better. This is not one of the better times in America's economic history over the last 15 or 20 years.

Senator LONG. Will the Senator yield to that point?

Senator ARMSTRONG. Yes, of course.

Senator LONG. May I say that there may be someone doing better in this world, but there is nobody doing much better. We are the greatest Nation in the history of the world.

We have the highest standard of living the world has ever known. And, as a people, we are doing better than we have ever done before.

Senator ARMSTRONG. And our productivity——

Senator LONG. We have more income after taxes, more net income than the American people have ever had before. The only problem is to see to it that everybody can get in on the act and enjoy some of the bounty that this Nation has to offer.

Basically what I am speaking to, and what these witnesses are speaking to, is that with all the wealth that we have in this Nation there is no real need why any person who wants to do the right kind of thing or to make his contribution ought to have to starve or live in poverty or do without.

I happen to feel that way about it. I think these witnesses do too. They are saying that we have in the foreseeable future the resources to look after the old people, and we are going to look after them.

I would welcome the chairman of this committee, or the chairman of this subcommittee, or the leadership on the other side of the aisle, making clear that we have no intention of letting these dear old people suffer. We are not going to let them down. A lot of them are worried very much today because of some propaganda which I think should have been left at home and never should have been published to begin with.

Senator ARMSTRONG. Well, I can assure the Senator that in my opening remarks on Tuesday, and again this morning, I made it very plain that it is my dedication that the promises which have been made to retirees will be kept.

That is the very reason for these hearings—to determine what steps are necessary to protect the integrity of the system.

By the same token, we have, in the last few minutes, been talking about the tax on employment, its burden on the economy, and what it says about savings, investment, growth opportunities, and productivity. The working men and women of America are also a part of this system and deserve to be considered, too.

Senator MOYNIHAN. Mr. Chairman, may I speak?

Senator ARMSTRONG. Yes, Senator Moynihan, you are going to get the last word and then we are going to call the next panel.

Senator MOYNIHAN. All right. I just want to make a very friendly proposal that the next time we hold hearings like these, we have a joint committee on charts. [Laughter.]

Senator ARMSTRONG. We do have, and it's you and I.

Senator MOYNIHAN. Well, what is the purpose of these charts except to terrify?

[Going to charts.]

Do you know what the gross national product of this country was when Franklin D. Roosevelt came into office—it was $58 billion. It is $2.6 trillion today.

Now we have a problem in the next 10 years of finding $10 billion for this system; $10 billion—10 out of $2,000—is the 10-year shortfall.

Then the proportion of gross national product that is used by this system goes down, down, down for 35 years.

Now why should I throw the bombs around the country, that we are broke, we are bust, we are price shocked—crisis, crisis, crisis.

Senator ARMSTRONG. Who said any of that?

Senator MOYNIHAN. I can tell you, sir. The trustees—trustees of social security, who should know better—put out a report. Inside of which you found that there was no impending disaster. But a two-page press release uses the word "crisis"—page 1—"crisis," "crisis," "bankrupt"—you turn over, "crisis," "crisis." Four crises, one bankrupt and two pages. [Laughter.]

There is no point in terrifying older people. And no one is going to do this to them, not while Russell Long has a voice and the Senate has a say.

Senator ARMSTRONG. Thank you, Senator Moynihan.

Thank you, panelists.

I have not read the press release. I did read the report. I can see that's where I made my mistake. I should have read the press release instead of reading the trustees' report. [Laughter.]

[Statements follow:]

STATEMENT OF BERT SEIDMAN, DIRECTOR, DEPARTMENT OF SOCIAL SECURITY
AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS
BEFORE THE SUBCOMMITTEE ON SOCIAL SECURITY
SENATE FINANCE COMMITTEE
ON SOCIAL SECURITY

July 10, 1981

We appreciate the opportunity to present our views on the financing of the social security program. Public discussion addressed to social security financing is both necessary and helpful. But we do not accept the unfounded allegations that the system is bankrupt now or will be in the future. To workers who contribute to the system from their earnings every payday, spreading such unwarranted doubt is a cruelty. It is inconceivable that Congress would let social security benefits be delayed or unpaid. That is why American workers can be confident that social security will always pay benefits on time as it has for more than 40 years.

The latest Social Security Trustees' Report adds little to facts that were already known although the media coverage may have given a contrary impression. The AFL-CIO has been well aware of this situation and has repeatedly urged actions to deal with these problems. We do so again today.

The report of the Social Security Trustees projects a serious cash-flow problem in the near future. The report projects -- even with interfund borrowing -- that the three trust funds combined may need additional money because expenditures will probably exceed anticipated income and reserves for a period of years. The Trustees emphasize that the trust fund situation will likely remain unsatisfactory for the next five to ten years but fail to emphasize that the situation will then improve and will remain favorable into the next century.

While these short-term cash-flow problems require attention and solution, there is no need to reduce any benefits and certainly no excuse whatsoever for deep slashes in basic social security protections so essential to both present beneficiaries and future retirees. There are alternatives to the Administration's massive program reductions. We recommend financing 50 percent of Medicare (Part A - Hospitalization Trust Fund) out of general revenues and transferring one-half of the Medicare tax to the Old Age and Survivors' Trust Fund (OASI). This action would finance the various social security programs well into the next century. The United States is one of the few advanced industrial nations in the world in which the social security system is financed almost entirely from payroll taxes.

In addition to 50 percent financing of Medicare from general revenues, we urge the following back-up actions to insure that Congress will not again be forced to deal with a short-term financing problem:

1. Reallocate a portion of the tax rates now earmarked for the Disability and Hospital Insurance Trust Funds to the OASI Program. This is superior to borrowing authority since it deals with the problem before it occurs. In other words, try to resolve developing shortfall problems in advance and avoid the public concern that would arise if an announcement is made that interfund transfers will have to be made because the OASI Trust Fund is running out.

2. Authorize interfund borrowing to provide flexibility and back up in the event the reallocation is not sufficient.

3. Insulate social security from the effects of recessions. High unemployment can severely reduce social security contributions and the income

to the Trust Funds. Congress should authorize the use of general revenue to compensate the social security trust funds during such periods for the decline in payroll taxes that would be forthcoming in the absence of high unemployment. President Carter proposed this in 1977.

4. Put into the Social Security Law a provision stating that social security benefits, like interest on the national debt, will be paid from general revenues in the event payroll taxes are insufficient. The present moral obligation to pay benefits should become a legal one. This would reassure beneficiaries and contributors and strengthen public confidence in the program. A similar provision actually was part of the Social Security Act from 1944-1950.

In all likelihood these suggestions probably would resolve the long-range financing problem. But there is no pressing need to deal definitively with this problem until the many variables can be judged with a greater degree of certainty. Extremely small differences can result in very large variations when compounded 75 years into the future. Corrective action can and should be taken when we can judge the future a little better over a shorter time span.

If it were thought important to show an exact 75-year actuarial balance, one possibility would be to set a tax rate in the next century that would fully finance the program in the long-run. Congress has used this approach in the past and the last Advisory Council on Social Security recommended this device. But this should be done with the understanding that such a tax rate based on so many dubious and volatile assumptions would undoubtedly have to be adjusted at some future time.

Mr. Chairman, we are deeply concerned about proposals which have been advanced under the guise of dealing with social security's financing problems which go far beyond legitimate concerns about the program's financing.

The most recent example is the Reagan Administration's proposed slashes in social security protections advanced under the pretext of dealing with these problems. None of these cuts are necessary. Under the proposal, early retirement benefits are cut by as much as 43 percent and the disability program by one-third. The 21-23 percent cut in overall benefits creates an actuarial surplus much larger than needed to balance the system for the next seventy-five years. The objective seems to be benefit cuts rather than sound financing of the system. In short, the Administration is proposing unwarranted cuts that would devastate the program in order to serve its political, philosophical and budget objectives.

The cornerstone of these proposals is the cutback in early retirement benefits. Under current law, workers electing or forced into early retirement at age 62 receive 80 percent of full benefits -- an actuarial reduction. The Reagan plan would cut this to 55 percent and other proposed changes in the benefit computation formula would actually reduce the amount to below 50 percent of the full benefit. The full benefit is already too small -- about 41 percent of preretirement earnings for the average worker. The result after the proposed slash would be no retiree at age 62 in 1982 could receive a benefit as high as the official poverty threshold.

A logical and fair action to accompany this harsh proposal would be to liberalize the disability program to lessen the impact on the majority of workers who retire early because of ill health or inability to find a job. Instead the Administration proposes to restrict even further the already too restrictive eligibility requirements for disability insurance and to cut the overall disability program by one-third. To place this in perspective, consider that 80 percent of those who apply for disability benefits and are denied eligibility are never able to work regularly again. These disability proposals should not be adopted.

Mr. Chairman, the AFL-CIO opposes all proposals that would raise the age of retirement, increase the actuarial reduction or in any way tamper with the early retirement provisions of the law for they all place an unequal burden on those in poor health and on blue collar workers whose jobs require physical effort. Such proposals would also have a devastating impact on the early retirement provisions of collectively bargained pension plans.

The Administration proposes to reduce future benefits an average of ten percent by a technical change in the computation formula during the next five years.

A punitive proposal also would eliminate the so-called "windfall" benefits which rightfully accrue under current law to federal, state and local retirees who qualify for social security from other employment. This provision would deny these employees benefits which they have earned and is part of the Administration's strategy of placing a disproportionate burden on public employees for dealing with the Administration's budgetary problems.

In addition, the Reagan Administration would postpone the 1982 cost-of-living increase for all social security beneficiaries, extend the disability maximum family benefit to retirement and survivors cases, eliminate children's benefits in early retirement cases and apply the payroll tax to the first six months of sick pay. These are all objectionable proposals.

We also oppose proposals that would modify the social security cost-of-living formula as a way of lessening the system's funding shortfall. Such proposals take various forms but all mistakenly assume that retirees are over-compensated by the present Consumer Price Index (CPI) and would deny beneficiaries the full value of their cost-of-living increases.

More than other groups in the population, the elderly live on fixed incomes and have little or no opportunity for personal improvement of income. Actually, the cost-of-living adjustments are only partially helpful since, at most, they restore buying power well after the fact and most retirees have little in the way of savings to sustain themselves until the catch-up. Private pensions, with rare exceptions, are not indexed with the CPI and for those who partially depend on such supplementary pensions their living standards are declining rapidly.

Only one Administration proposal, to phase-out the retirement test over a three year period, would increase costs. But its elimination would inordinately benefit that small percentage of workers eligible for social security benefits and would come at the expense of benefits for the large majority of beneficiaries who are unable to work because of poor health or lack of employment opportunities. Priority consideration should be given to these beneficiaries who would not be helped by the elimination or further liberalization of the retirement test.

In total, the Administration's proposals represent a massive assault on the social security program.

The argument is made by the Administration and others that these major program cuts are necessary because of the growing burden of older people. The low birthrate means a proportionately smaller labor force will have to support a much larger proportion of older people as the "baby boom" becomes the nation's retirees. A larger proportion of the nation's income will be required to support the elderly. Thus, the argument goes, something must be done about this growing economic burden.

Those making this argument neglect to mention some offsetting factors. A lower birthrate will mean a proportionately smaller labor force but also fewer children, unemployed and disabled. Lower expenditures for these groups can be used to support retirees. In short, in any society, the population at work has to support those that can't work. The total dependency burden for active workers will not change much -- more will be older people but there will be fewer in the other categories. The burden of the retired for the economy as a whole will be offset to a large degree, perhaps totally, by the decline in society's support required for other groups.

Unfortunately, these compensating factors are only slightly reflected in direct monetary gains to the program because of the circumscribed manner in which the social security program is funded. The problem is how to channel some of the savings from the decline in certain dependency categories to the social security program in order to help pay for the higher costs for retirees. We believe the best way to do this is to tap general revenues to help finance the system.

Because the Administration's proposals are so extreme, it may increase the willingness of some members of Congress and some Americans to accept major program cuts that are somewhat less drastic than the Administration's recommendations. This appears to be the Administration's fallback strategy since Secretary Schweiker has stated that its proposals are negotiable. This approach has and will be accompanied by politically motivated exaggerations as to the financial condition and the economic burden of the social security program. The many unfortunate proposals now pending in Congress, which if enacted, would greatly lessen longstanding social security protections give evidence that this strategy has been much too successful.

Mr. Chairman, the AFL-CIO recognizes the need for strengthening the financing of the program but we believe this can and should be done without reducing benefits for either beneficiaries or for those now contributing to the program who must depend on it in the future.

Workers have paid contributions during their working lives confident of receiving specified benefits. It would be a breach of faith to deprive them of these benefits. Nothing would do more to shatter the confidence of the American people in the social security program.

Congress should meet the problem head on and, in our opinion, is honor bound to meet program commitments. There are effective ways to fully finance the program without slashing benefits and we urge you to support them. And in so doing, we pledge to you our support and guarantee that we will play a constructive role in placing the social security system on a sound financial basis.

Statement By the

American Federation of State, County and Municipal Employees, AFL-CIO

Before the

Subcommittee on Social Security
and Income Maintenance

Finance Committee
U.S. Senate

on

Financing of Social Security and Options for the Future

July 10, 1981

Mr. Chairman and distinguished members of the Subcommittee, I am Josiah Beeman, Director of Political and Legislative Affairs of the American Federation of State, County and Municipal Employees (AFSCME), AFL-CIO. I am accompanied by Charles M. Loveless, AFSCME's Counsel for Employee Benefits. We are here today representing the more than one million of our members who work in state and local governments across the nation. We appreciate the opportunity to present AFSCME's views on the financing problems faced by the Social Security system and options for the future.

AFSCME has a major interest and stake in the protection of the integrity and financial viability of the Social Security system. The great majority of our members count on Social Security as an essential protection for themselves and their families against loss of income, whether by old age, disability or death. Social Security in effect represents a compact between those workers who have contributed to the system and the Federal Government, and we therefore share with you a major concern regarding the continuing financial difficulties of the program.

In February, the Congressional Budget Office (CBO) projected that by the beginning of fiscal 1982, the balance in the old-age and survivors (OASI) trust fund will fall to 14.0 percent of the estimated $141.4 billion needed for that year's outlays and that by early 1983, the OASI fund will be depleted. CBO also estimated that the disability insurance (DI trust fund will improve its position through 1986 with reserves increasing to 112 percent of outlays and that the hospital insurance (HI) fund's reserve balance will remain at approximately 50 percent of outlays through this period. CBO indicated that even with improvement in the economy during the next two years, the combined reserve position of the three trust funds is expected to worsen and may not be adequate to avoid cashflow problems. See "Paying for Social Security: Funding Options of the Near Term," (CBO, February 1981), p. xii (hereafter referred to as CBO Study). Therefore, it is clear that some action must be taken this year to at least address the short-term financial problems -- and, hopefully, the long-term problems -- faced by the Social Security system.

Social Security's funding problems stem from the continued rate of unexpectedly high inflation and from the period of high unemployment and slow real wage growth which characterized the mid-1970s. As noted in a recent House Social Security Subcommittee report, "(t)he period of financial difficulty for the Social Security system which occurred in the mid-1970's, as well as the current period of difficulty, has been caused principally by adverse conditions. High inflation has caused large benefit increases to be paid out, while reserves failed to keep pace with the additional outgo because of lower real wage growth and higher unemployment." "Social Security and Economic Cycles," Subcommittee on Social Security of the Committee of Ways and Means (1980), p. 1.

AFSCME believes that there are several actions which should be taken by the Congress to maintain the integrity of and bolster confidence in the Social Security system. First, we think the time has come to reduce reliance on the payroll tax and to finance a significant portion of Social Security with general tax revenues. Second, we support the proposal most recently advanced by the National Commission on Social Security (National Commission) permitting inter-fund borrowing among the trust funds. Third, we believe that the trust funds should be authorized to borrow from the Treasury such amounts as necessary to assure the timely payment of benefits if total revenues for the program prove inadequate.

AFSCME opposes any changes in Social Security which would cut into the heart of the income protections provided by the program. Specifically, we oppose the various benefit reductions proposed by the Reagan Administration on May 12. Moreover, we oppose any change in the basic cost-of-living indexing method for computing benefit increases and any proposed increase in the normal and early retirement ages for receiving cash benefits and Medicare. We set forth below, in greater detail, our views on these extremely important policy questions.

I. THE TIME HAS COME TO REDUCE RELIANCE ON THE PAYROLL TAX AND TO FINANCE A SIGNIFICANT PORTION OF THE SOCIAL SECURITY PROGRAM WITH GENERAL TAX REVENUES.

AFSCME strongly supports an across-the-board use of general revenues to finance the Social Security program. Such a step, we believe, would not only be consistent with the historic foundations of the program but also would ensure greater equity in how the program is financed.

The original drafters of the Social Security program, successive Social Security advisory councils and numerous Social Security experts have urged that general revenues be tapped as a major source of funding for the program. In 1935, President Roosevelt's Committee on Economic Security, which is credited with being the architect of Social Security, recommended that general revenues be used to fund the program's deficit anticipated to occur after 1965. Although the President rejected the Committee's recommendation and decreed that the program was to be financed entirely through the payroll tax, successive Social Security advisory councils have repeatedly called for using general revenues to finance at least a portion of the program:

-- The 1938 advisory council recommended that general revenues eventually be introduced into Social Security and gradually be increased to the point where the program would be one-third financed from general revenues.

- The 1948 council concluded that there were "compelling reasons" for an eventual general revenue contribution to Social Security but that there was no current need to decide on the timing or amount of the general revenue infusions.
- The 1965 council recommended that a small general revenue contribution (equivalent to 0.15 percent of payroll for 50 years) be used to finance the cost of Medicare benefits for those already retired or disabled when the program began.
- The 1971 council recommended that one-third of parts A and B of Medicare taken as a whole should eventually be financed by general revenues.
- The 1975 council recommended that general revenues gradually be introduced into the hospital insurance program and that payroll taxes scheduled for the hospital insurance trust fund be gradually shifted to the old-age and survivors' and disability insurance trust funds. 1979 Advisory Council Report, p. 36.

In supporting a proposal to finance the HI program entirely with earmarked general revenue funds, the 1979 Advisory Council reaffirmed this recommendation. See 1979 Advisory Council Report, pp. 35-42. Finally, numerous experts on Social Security and retirement policy have argued for the need for at least limited general revenue financing. See, e.g., Robert M. Ball's Social Security Today and Tomorrow (Columbia University Press, 1978), pp. 429-438.[1/]

1/ To a limited extent, general revenues already have been introduced into the Social Security program. In this regard, the SMI program (Part B of Medicare) currently receives significant general revenue support with the government's share of financing SMI representing 71 percent of the cost of the program.

The regressive features of the Social Security payroll tax have been noted by numerous economists ranging the ideological spectrum from Joseph Pechman to Milton Friedman. See, e.g., The Crisis in Social Security (Institute for Contemporary Studies, 1977), pp. 27-28, 33-34. The tax takes a constant proportion of a worker's income up to a set maximum and thus clearly falls more heavily on workers with low or moderate incomes. As stated by the 1979 Advisory Council, the payroll tax has a regressive structure for several reasons:

-- There is a limit on the amount of earnings subject to the payroll tax.

-- The payroll tax has no exemptions or deductions.

-- The payroll tax rate is constant rather than increasing at higher income levels.

-- Income from interest, rents and profits is not subject to the payroll tax at all, and most of this income is received by persons in the highest income brackets. Social Security Financing and Benefits (Report of the 1979 Advisory Council on Social Security, December 1979), p. 77 (hereafter referred to as 1979 Advisory Council Report).

While the earned-income tax credit, enacted as part of the Tax Reduction Act of 1976, helps relieve the burden of the payroll tax for workers with taxable incomes in the lowest income groups, the credit is restricted to families with dependent children, subject to an income ceiling of $10,000, and, thus, only partially eliminates the regressivity of the tax. Moreover, the regressivity of the payroll tax is further accentuated by the fact that the tax on the employer, as well as that on the employee, is ultimately borne by the employee either because the tax makes wages and fringe benefits lower than they otherwise would be or because the tax drives up prices and profits while leaving wages unchanged.[2]

We belive the use of general revenues as at least a partial supplement to payroll tax financing is desirable for several reasons. First, important parts of the benefit structure of the Social Security program, notably dependents' benefits, the "weighting" in the benefit formula and the minimum monthly benefit, more closely resemble the features of a means-tested general welfare program than a contributory retirement program and therefore are more appropriately financed by general revenues than direct employer and employee contributions. In this regard, Robert Ball states:

> I believe that the government contribution to the program should help pay the cost of dependents' benefits, the cost of giving lower-paid workers under the system the advantage of a weighted benefit formula, and as long as we have it, the cost of giving those who work only part-time under the system the advantage of a minimum benefit. It seems to me proper that the cost of these provisions designed to more adequately meet the needs of lower-paid people and to some extent those with dependents should, over the long run be borne in part by taxes on income from capital and on earnings above the maximum covered under Social Security.

2/ The 1979 Advisory Council Report also emphasizes the effect of payroll tax rate increases on inflation. "They (payroll tax increases) do so," the Report states, "because the employer's portion of the tax directly adds to labor costs per unit of production." 1979 Advisory Council Report, p. 37.

> Since the minimum benefit, the weighted-benefit formula, and dependents' benefits relieve the general taxpayer of a major part of cost of general-revenue supported, means-tested programs, it seems reasonable to me that the general taxpayer should make a contribution to pay for this social weighting in the social insurance system (emphasis added). Social Security Today and Tomorrow, p. 430.

Since the nation as a whole, independent of Social Security beneficiaries, benefits from the program in terms of decreased public assistance payments, we believe it only fair that general revenues, which are derived from the more progressive income tax rather than the tax on earnings and payroll, substantially contribute toward the cost of the program.

In AFSCME's view, the economic and social benefits conferred by Social Security on the nation as a whole go beyond merely avoiding increased public assistance payments. As stated by the first Social Security Advisory Council and reaffirmed by successor advisory councils, the general welfare of our democratic society is well served by a viable social insurance system which prevents the growth of dependency. Dependent old age is certainly a national problem, and the establishment and maintenance of a federal program which is designed to prevent or at least mitigate the effects of dependency is a necessary general governmental expenditure.3/

3/ It should be noted that general government financing of social insurance programs is a long-established public policy in many other countries, See, e.g., Social Security Today and Tomorrow, pp. 438-440.

We believe a constructive first step toward the objective of supplemental general revenue financing of the Social Security program would be to partially finance Part A of Medicare in this manner. We support the proposal advocated by Congressman Pickle, Chairman of the House Social Security Subcommittee, in H.R. 3207, Congressman Conable in H.R. 1018, former HEW Secretary Cohen and other individuals to transfer half of the taxes that currently finance HI to the cash benefit programs (OASDI) and to replenish the HI trust fund with general tax revenues. This would ensure both a substantial reduction in the regressive payroll tax and the long-term financial soundness of the Social Security program.

It should be noted that many individuals and groups who oppose general revenue financing of the cash benefits do not oppose such financing of the Medicare program. They point out that the primary argument used in justification of payroll tax financing -- namely, that benefits received are related to the individual's covered earnings -- does not apply to the HI program. Everyone who is eligible for HI receives the same protection, and, therefore, the amount of HI benefits received is related not to prior earnings but to the need for hospital care and services.

II. INTER-FUND BORROWING AND BORROWING FROM THE TREASURY SHOULD BE ALLOWED TO ASSURE THE TIMELY PAYMENT OF BENEFITS.

As a means of helping resolve the short-term cashflow problems of the Social Security program, the National Commission, in its final report, recommended the enactment of legislation authorizing inter-fund borrowing among the OASDHI trust funds whenever needed to assure timely payment of benefits, with the loans being repayable with appropriate interest. The President's Commission on Pension Policy also endorsed this approach. See Coming of Age: Toward a National Retirement Income Policy (President's Commission on Pension Policy 1981), p. 46.

While we support inter-fund borrowing as a means of attempting to address the very short-term financial problems of the Social Security system, it is clear that the amount of revenue generated for the OASI fund from this device will not be sufficient to protect the system from even mild economic downturns. In fact, under CBO's current economic projections, the combined OASDHI trust fund reserve balance will be inadequate to meet benefit obligations by the start of 1984 and leaves very little margin for possible worse economic conditions before that date. Accordingly, we believe inter-fund borrowing represents only a stop-gap solution to Social Security's immediate financial needs and should not obscure the need to address the critical problems which the system faces.

AFSCME also recommends that the trust funds be authorized to borrow from the Treasury such amounts as necessary to assure the timely payments of benefits if total revenues, after reallocation and inter-fund borrowing, prove inadequate. This proposal, in various forms, is endorsed by the 1979 Advisory Council and the National Commission on Social Security. Adoption of this proposal will make it clear to the public that Congress will not tolerate any interruption of Social Security benefit payments and therefore will go a long way toward restoring public confidence in the financial soundness of the system.

Of course, it should be noted that policies designed to promote economic growth without inflation would have a positive impact on the financial conditions of the Social Security trust funds. The sensitivity of the trust fund balances to general economic circumstances strongly suggests that priority attention be given to developing a comprehensive economic growth program.

III. THE VARIOUS BENEFIT CUTS PROPOSED BY THE ADMINISTRATION SHOULD BE REJECTED.

On May 12, the Administration proposed a series of sweeping reductions in Social Security benefits for all current and future beneficiaries. These benefit cuts include: major reductions in early retirement benefits, major reductions in disability benefits, a significant reduction in the wage replacement rate for all future retirees, a major reduction in benefits for workers who have earned pensions in non-covered employment, a significant reduction in benefits for all current beneficiaries by moving the date for calculating the automatic cost-of-living adjustment and using a 12 month CPI average and a significant reduction for all persons receiving retirement and survivor benefits by extending the DI cap on family benefits to such cases.

As indicated above, AFSCME has a long-standing general policy opposing any proposed changes in the Social Security program which would cut the present income protections provided by the system. A copy of the AFSCME policy statement on this issue is set forth below as Attachment A. We strongly oppose the benefit cuts advocated by the Administration because we believe such reductions would cut into the heart of the income protections provided by Social Security and would break faith with workers who have been paying Social Security taxes on the assumption that they would receive certain benefits in return.

To the extent that any modifications in the program are contemplated, such changes should be carefully studied and phased in over a long period of time to preserve the continued faith of the public in the promises of the Social Security system. In most cases, the Administration proposals would impose significant benefit cuts immediately, allowing no transitional period within which time workers could readjust their retirement plans. Such cuts constitute a major breach of contract for workers who have paid Social Security taxes for 30 or 50 years and who have planned for retirement on the basis of the current benefit structure. AFSCME strongly opposes any benefit reductions which would be imposed immediately and thus undermine workers' reasonable benefit expectations.

A. Early Retirement Benefit Reductions.

The Administration advances three proposals which would substantially reduce benefits for those workers who retire before age 65. The largest reduction in benefit levels for early retirees would result from the Administration's proposal to reduce the benefits received by workers who retire at age 62 from the current 80 percent of the full benefit level to 55 percent. Furthermore, the spouse's benefit for the age 62 retiree would be 27.5 percent rather than the current 40 percent of full benefits.

In addition to reducing benefit levels for early retirees, the Administration proposes a change in the years which are included in the formula for computing the Average Indexed Monthly Wages (AIME). Under the proposal, the years between 62 and 65 would be counted in calculating the AIME so that those workers who retire at age 62 would have three years of low or zero earnings entered into the AIME computation. The net effect of this proposal is to lower significantly the earnings base on which the benefits of early retirees are calculated.

Finally, the Administration proposes to eliminate children's benefits for those retired workers aged 62 to 64.

It should be emphasized that the current benefit reduction for early retirement is designed to be actuarially neutral. This reduction takes account of the longer period over which benefits normally would be paid if the worker opts to retire before age 65. As noted by former Social Security Commissioner Ball, "(o)n average, the lower benefit produces the same total payments as the higher rate payable at 65 over a shorter period of time," Social Security: Today and Tomorrow, p. 36. By more than doubling the reduction factor for a worker's early retirement benefits and almost doubling the reduction factor for a spouse's benefits the Administration unfairly seeks to penalize those exercising the early retirement option.

In support of its proposals in this area, the Administration argues that these benefit reductions will serve to reduce the number of workers opting for early retirement. However, recent studies by the Social Security Administration indicate that only 20 to 22 percent of the early retiree group take early retirement voluntarily. The remainder retire because of their own poor health or the poor health of a family member or because of labor market conditions or other adverse circumstances over which they have no control. See Reaching Retirement Age, Social Security Administration, Department of Health, Education and Welfare's Office of Research and Statistics (1976). In short, most of these workers lack the physical ability to work at their usual occupations or cannot find work and are not likely to find another job given their health and/or age.

These benefit reductions are not only extremely unfair to those workers who are forced into early retirement, but, by imposing the reductions immediately, they defeat workers' reasonable benefit expectations and allow them no time to adjust their retirement plans accordingly. The proposals clearly break faith with the current generation of workers who have been paying Social Security taxes on the assumption they they would receive certain benefits in return. They raise new doubts about the credibility of the Federal Government's promises and will disrupt the retirement plans of millions of American workers.

B. Disability Benefit Reductions

The administration proposes four major changes in the Disability Insurance program, in addition to the disability benefit cap and a more stringent recency-of-work test proposed in the fiscal 1982 budget. It proposes to limit qualification for DI benefits to medical factors alone, increase from 5 to 6 months the waiting period for receiving DI benefits, require that workers applying for DI benefits show that the disability claimed exceeds

24 months in duration (as opposed to the 12 months required under present law) and increase the requirement for insured status under the program from 20 to 30 of the past 40 calendar quarters. These changes are all substantial new barriers to qualifying for DI benefits and, if implemented, would result in a one-third reduction in DI outlays over the next five years.

It should be noted that the current disability determination process is already very stringent. The present definition of disability, supplemented by vigorous SSA implementation, operates to deny disabled workers' benefits if they are considered able to perform any job at all, no matter how different from their work history, how unlikely their chances of being hired or the location of the job from their homes.[4] Such a definition of disability fails to take into account older, disabled workers who, even in periods of high employment, face overwhelming obstacles in attempting to locate work.

---

[4] Section 223(a)(2)(A) of the Social Security Act, as amended, states, in relevant part:

> An individual ... shall be determined to be under a disability only if his physical or mental impairment or impairments are of such severity that he is not only unable to do his previous work but cannot, considering his age, education and work experience, engage in any kind of substantial gainful employment which exists in the national economy, regardless of whether such work exists in the immediate area in which he lives, or whether a specific job vacancy exists for him, or whether he would be hired if he applied for work (emphasis added).

In addition to being required to meet the very stringent definition of disability and being fully insured for regular Social Security purposes, a DI applicant already must meet a test of substantial recent covered work -- five of the last ten years in covered employment. This recency-of-work requirement has had the effect of denying benefits to persons who gradually become disabled due to progressive illness. Such persons have increased difficulty keeping steady employment, and by the time their impairments progress to the point that they meet the stringent disability test, they are unable to meet the current recency-of-work test.

In 1980, the Congress enacted major reforms in the DI program. H.R. 3236, the Disability Insurance Amendments of 1980 (P.L. 96-265), significantly strengthened federal management of the DI program, reduced the number of dropout years afforded disabled workers and placed a limitation on total DI family benefits. The amendments also included several new work incentive provisions.5/

5/ The new law's work-incentive provisions, some of which became effective December 1980, include the following:

- o Social Security disability benefits and supplemental security income (SSI) disability payments may be reinstated without a new disability application if, during the 15-month period following a trial work period, a person who has not recovered medically no longer engages in substantial gainful activity (SGA).
- o Medicare protection will be provided during the automatic reentitlement period and for 25 additional months.

(continued on following page)

Even prior to passage of H.R. 3236, a declining trend has been noted in the number of disability benefit awards. The number of disability benefit awards has been declining since 1976, and this trend was particularly pronounced in 1978. The number of awards dropped from 592,000 in 1975 to 390,000 in 1980, and the number of disabled worker benefit awards per 1,000 insured workers now stands at 4.1 which represents the lowest award rate in the DI program's history, except for 1964 when it was 4.0.

The combined effect of the Administration's new DI proposals is to place an even greater burden on older disabled workers who face a remote chance of finding a new job and on those workers of all ages suffering from progressively debilitating illnesses. Over a third of all current DI beneficiaries between 62 and 65 had at least some nonmedical factors taken into account in determining their eligibility. See Congressional Budget Office Memorandum, dated June 9, 1981, entitled "The Administration's New Social Security Proposals," p. 7 (hereafter referred to as CBO

(continued from preceding page)

- The 9-month trial work period has been extended to disabled widows and widowers.
- Certain impairment-related work expenses may be deducted from earnings of disabled beneficiaries in determining SGA for Social Security and SSI purposes and in computing disability payments under the SSI program.
- If a previously disabled worker again becomes entitled to Social Security disability benefits within 5 years, Medicare coverage can be resumed immediately if the person has previously met the 2-year waiting period. If he or she previously received checks for less than 2 years, those months during which payments were received count toward meeting the waiting period.

Memorandum) which is set forth below as Attachment B. Excluding age, vocational and educational factors from the determination of DI benefit eligibility means that these workers would have lost their entitlements.

Requiring 30 covered quarters out of the last 40 for insured status under the DI program will have a particularly severe impact on those workers suffering from progressively disabling illnesses. As noted above, such workers face substantial impediments to qualifying for DI benefits under current law, and the Administration's proposed stricter insured status requirements will serve to further compound the likelihood that these workers will lose their disability insured status. Further, it has been noted that the stricter insured status requirements will have a disproportionately greater impact on women and on those minority groups with significantly lower labor-force participation rates; "...female workers who have spent over 2.5 years out of the last 10 out of the labor force due to home responsibilities would also be excluded, as would those who had experienced substantial periods of unemployment." CBO Memorandum, p. 7.

C. Reducing the Wage Replacement Rate for Future Retirees.

The Administration proposes to increase the "bend points" (the dollar amounts referred to in the weighted benefit formula) by 50 percent (instead of 100 percent as authorized in current law) of increases in average wage earnings for the years 1982 to 1987. The effect of this proposal is to significantly lower the wage replacement ratio -- how much of a worker's last paycheck is replaced by his or her first benefit check -- from the current 41.4 percent to 38 percent over five years.

This proposed benefit reduction represents the largest cut over the long run (over the next 75 years) in total program expenditures. A recent draft report prepared by Chairman of the House Select Committee on Aging points out that "(a)mending the indexing formula from 1982 to 1987 would reduce benefits by an average of 9.5 percent for persons retiring at age 65 in years past 1986." "Impact of Administration's Social Security Proposals on Present and Future Beneficiaries (Draft)," a report prepared by the Chairman of the House Select Committee on Aging, May 31, 1981, p. 14 (hereafter referred to as House Select Committee On Aging Report).

This proposed change in the formula used to calculate benefits would particularly hurt those workers nearing retirement age. These individuals will have virtually no time to adjust their retirement plans so as to be able to absorb this major cut in primary benefits.

D. Reduction in Benefits for Workers with Pensions from Non-covered Employment.

The Administration proposes to eliminate "windfall" Social Security benefits received by retirees who have worked in non-covered employment. The proposal is that for those workers who have earned pensions in non-covered employment, the benefit calculation formula would be revised by reducing the replacement rate in the first AIME bracket by 58 percent, from 90 percent to 32 percent; only covered employment income would be subject to this new formula.

While the Administration defends this proposal as eliminating the "windfall portion" of Social Security benefits for workers who have entered Social Security-covered employment for only a few years, it has been noted by the Congressional Budget Office that it will most severely affect those workers who have contributed to Social Security for most of their working lives but have also earned a small non-covered public pension. In this regard, CBO points out that "...the size of the pension would not be considered in setting the benefit reduction rate, so that all those who had worked in non-covered employment would be affected equally even if their pensions were very small... Thus, someone with a substantial period in covered employment, and only a very small pension based on a short period in non-covered employment, could be affected more than someone with a large pension from non-covered employment but only a short period of contributing to the Social Security system." CBO Memorandum, p. 9 (emphasis added).

An even more fundamental objection to the Administration's proposal is that it would be imposed immediately on future retirees defeating their reasonable benefit expectations and allowing them no time to adjust their retirement plans accordingly. Large numbers of persons have worked for and planned on receiving a certain level of Social Security benefits as an essential part of their retirement income, and we believe it would be unfair to remove this protection which they are counting on. Such an action would only serve to erode further public confidence in the Social Security system.

E. Moving the Date for the Automatic Cost-of-Living Adjustment from June to September and Using a 12 Month CPI Average.

This proposal not only will cause a loss of three months of cost-of-living adjustments for Social Security beneficiaries but also will change the method by which the adjustment is calculated. Rather than comparing the rate of change between the first quarter of the benefit year and the first quarter of the preceding year -- which are likely to be the high and low points of the measuring period -- the change in inflation would be calculated by a 12 month average which will moderate the highs and lows and is likely to show less difference between years than the current method.

It should be emphasized that this proposal amounts to a cut in benefits of all 35.7 million current OASDI beneficiaries, contrary to promises made by the President as recently as his speech to Congress on February 18. The Chairman of the House Select Committee on Aging estimates that "(t)he delayed COLA would reduce benefits by an average of $119.45 for the 19.6 million current beneficiaries receiving retired worker benefits." House Select Committee on Aging Report, p. 24. When it is considered that for approximately three-fifths of all beneficiaries who are 65 or older, Social Security benefits represent 50 percent or more of their total income, this proposal would have severe economic consequences for millions of older Americans.

F. Extending the Disability Insurance Cap on Family Benefits to Retirement and Survivor Cases.

The Administration proposes to extend the cap on maximum family benefits enacted as part of the 1980 DI amendments to retirement and survivor cases as well. The DI cap equals 85 percent of the worker's AIME or 150 percent of PIA, whichever is smaller. While the DI cap on family benefits was enacted primarily due to Congressional concern that if DI benefits could be larger than previous earnings it could create a work disincentive, it have been noted that "(t)he argument concerning work disincentives seems largely inapplicable to the extension of the cap to retirees and survivors, since for the most part their work effort will be unaffected by the relationship between previous earnings and benefits." CBO Memorandum, p. 10.

If the cap is extended to persons who receive retirement or survivor benefits, it is clear that a major new financial hardship will be imposed on widows and widowers with at least one dependent under 18 years of age. The CBO Memorandum points out that if the Administration's proposal is enacted, children's benefits would be eliminated for most persons who retire at 65. Moreover, it also would "reduce benefits for surviving children with a parent who also received benefits to the level of those now received on the behalf of one child or less if the surviving parent were over 61." CBO Memorandum, p. 10.

VI. PROPOSALS TO TAMPER WITH THE CONSUMER PRICE INDEX AS A MEANS OF YIELDING LOWER COST-OF-LIVING ADJUSTMENTS AND TO RAISE THE NORMAL RETIREMENT AGE SHOULD BE REJECTED.

AFSCME opposes any proposal which would cap or reduce cost-of-living increases to Social Security beneficiaries. Under current law, whenever consumer prices, as measured by the Consumer Price Index (CPI), have risen by at least 3 percent since the measuring period for the last general adjustment, benefits are increased on an automatic annual basis by the percentage increase in prices. Any proposal which would cap the benefit increase, alter the construction of the CPI in a way that would yield a lower increase or use either a wage or price index (depending on which yields the lower increase) should be rejected. Any cutback in Social Security's inflation protection for the elderly would further jeopardize their already eroding living standards.

We also oppose those proposals which have surfaced in recent months raising the normal and early retirement ages at some future date for receipt of Social Security benefits. In our view, such proposals in effect constitute a benefit reduction and would break faith with the current generation of workers now contributing to Social Security who have a legitimate expectation that their benefits will become available at age 65.

V. CONCLUSION

AFSCME supports reforms that are necessary to preserve the financial integrity of the Social Security system. However, it is clear that the proposed cuts advocated by the Administration extend far beyond what is necessary to achieve a financially sound system. The Administration's proposals are very drastic, imposing devastating cuts on millions of current and future beneficiaries. They clearly would cut into the heart of the income protections provided by this most vital of government programs and break faith with the current generation of workers who have been paying Social Security taxes on the assumption that they would receive certain benefits in return.

The important point here is that there are other policy alternatives to the severe benefit reductions proposed by the Administration. AFSCME believes that partial general revenue financing is the most equitable and economically sound way of resolving the financial problems currently faced by the Social Security system.

AFSCME, *in the public service*

ATTACHMENT A

RESOLUTION NUMBER 20

24th INTERNATIONAL CONVENTION JUNE 9-13, 1980
ANAHEIM CONVENTION CENTER ANAHEIM, CALIFORNIA

PRESERVING THE SOCIAL SECURITY SYSTEM

WHEREAS:

AFSCME has a major interest and stake in the protection of the integrity and the financial viability of the Social Security system. The great majority of our members count on Social Security as an essential protection for themselves and their families against loss of income whether by old age, disability or death.

WHEREAS:

Recently a number of proposals have been advanced by individual members of Congress, the Administration, the press and the academic world which would cut into the heart of the income security protection provided by Social Security. These proposals, usually disguised as 'solutions' to inaccurate and alarmist reports regarding the long-term financial stability of the Social Security system, frequently extend beyond legitimate concern about future scheduled increases in the payroll tax. Many of these proposals would break faith with workers who have been paying Social Security taxes on the assumption that they would receive certain benefits in return. Concern regarding past proposed benefit cuts in the Social Security system prompted the AFSCME International Convention in 1978 to go on record strongly opposing such cuts and to reaffirm AFSCME's commitment to preserving the program's integrity and purposes.

WHEREAS:

The regressive features of the Social Security payroll tax which under current law will increase six times between 1979 and 1990 to a maximum rate of 7.65 percent have been noted by numerous economists ranging the entire ideological spectrum. The tax takes a constant proportion of a worker's income up to a set maximum and thus falls more heavily on workers with low or moderate incomes. The regressivity of the payroll tax is further accentuated since there is a limit on the amount of earnings subject to the tax and

COMMITTEE ASSIGNMENT ____________ COMMITTEE RECOMMENDATION ____________ CONVENTION ACTION ____________

RESOLUTION NUMBER 20

BEST COPY AVAILABLE

non-wage income is not subject to the payroll tax at all.

WHEREAS:

While Social Security coverage is mandatory for virtually all private sector workers, state and local government employees are covered on a voluntary basis. Despite a host of recent studies by pension and Social Security experts which clearly demonstrate that public employees who have their coverage terminated are the ultimate losers because Social Security benefits cannot be duplicated elsewhere, a growing number of state and local employers have exercised the unilateral power granted them under current law to terminate coverage for their employees.

WHEREAS:

The danger of the present voluntary coverage arrangement also adversely affects state and local workers who never had coverage. These workers frequently have to rely on financially unstable public pension plans which do not have the scope of the income security protections provided by Social Security.

THEREFORE BE IT RESOLVED:

That AFSCME will:

1. Make every effort individually and collectively with other groups to oppose any proposed changes in the Social Security program which would cut the present income security protections provided by the Social Security system;
2. Oppose taxing Social Security benefits which would effectively cut payments to more than ten million beneficiaries;
3. Oppose raising the age of eligibility to receive full Social Security benefits for future retirees;
4. Support efforts to reduce Social Security's reliance on the highly regressive payroll tax and to finance a significant portion of the Social Security program with general tax revenues; and
5. Oppose all efforts to withdraw covered employees from the Social Security system.

AND BE IT FURTHER RESOLVED:

BEST COPY AVAILABLE

That AFSCME continue to support enactment of federal legislation which will make Social Security universally available to public employees at all levels of government as long as the following conditions are met:

1. No reduction in the level of pension benefits now available to government workers;
2. No increase in the financial burden on public employees without a commensurate adjustment in benefits;
3. Maintenance of the identity of current public employee retirement systems; and
4. No diminution of the opportunity for these workers to improve their retirement systems in the future.

SUBMITTED BY: The International Executive Board

RESOLUTION NUMBER 13
PAGE 3 OF 3

BEST COPY AVAILABLE

ATTACHMENT B

CONGRESSIONAL BUDGET OFFICE
U.S. CONGRESS
WASHINGTON, D.C. 20515

Alice M. Rivlin
Director

MEMORANDUM

June 9, 1981

TO:

FROM: Pat Ruggles

SUBJECT: THE ADMINISTRATION'S NEW SOCIAL SECURITY PROPOSALS

The thirteen new proposals concerning the Social Security program which were released by the Administration on May 12 would result in both large net savings in Social Security, and some large reductions in benefits paid. The full package, taken together, would more than solve both the projected short- and long-run problems of the Social Security system under the Administration's economic assumptions. This memorandum outlines the impact of these proposals on the financial problems of the Social Security trust funds, and then discusses the details of the individual proposals.

I. SOCIAL SECURITY FINANCING ISSUES

Under the President's economic assumptions, there would be no short-run financing problem for Social Security, as long as interfund borrowing (or some other method of transferring funds from the DI and HI funds to OASI) were allowed. In order to continue to pay benefits in a timely fashion, the fund must contain a balance of 9 to 12 percent of anticipated outlays at the beginning of each year. As Table 1 shows, the combined balance of the OASDHI funds would be above this level through 1987, under the President's economic assumptions.

TABLE 1. THE ADMINISTRATION'S ESTIMATED SHORT-RANGE EFFECT OF THE THIRTEEN NEW PROPOSALS, AS COMPARED WITH PRESENT LAW (Fund Ratios at Start of Year)[a]

Calendar Year	Present Law	Proposal
1981	23	23
1982	21	22
1983	18	23
1984	16	25
1985	14	28
1986	16	30
1987	22	35

SOURCE: Press Release, U.S. Department of Health and Human Services, May 12, 1981, p. 7.

a. Balance in combined Old-Age and Survivors Insurance Trust Fund, Disability Insurance Trust Fund, and Hospital Insurance Trust Fund at beginning of year as percentage of outgo from trust funds in coming year (that is, assumes availability of inter-fund borrowing).

BEST COPY AVAILABLE

Even under CBO's more conservative economic assumptions, the combined balance in the OASDHI trust funds would not fall below the level needed to pay benefits on time until 1984 (see Table 2). A total of approximately $33 billion in savings or additional revenues would be needed to maintain a combined balance of 12 percent of outlays through 1986. This compares with projected total savings for these proposals of $46.4 billion under the President's economic assumptions, and $75 billion under HHS's "worst case" assumptions.[1]

TABLE 2. CBO PROJECTIONS OF OASI, DI, AND HI OUTLAYS AND BALANCES, 1981-1986 (In billions of dollars, balances as of end of fiscal year)

Trust Fund	1981	1982	1983	1984	1985	1986
OASI						
Outlays	122.6	141.4	158.7	178.0	199.3	222.6
Income	117.8	129.0	143.0	159.1	181.9	203.7
Balance	19.7	7.4	-8.2	-27.1	-44.5	-63.5
DI						
Outlays	17.5	19.6	21.0	22.7	24.8	27.5
Income	12.6	21.9	26.4	30.0	37.7	44.4
Balance	2.8	5.2	10.6	17.9	30.9	~~43.7~~ 47 7
HI						
Outlays	27.9	34.1	38.7	44.7	51.9	59.9
Income	31.9	38.3	43.2	48.4	55.5	65.5
Balance	18.5	22.7	27.2	30.8	34.4	40.1
Total OASDHI						
Outlays	168.0	195.1	218.4	245.4	276.0	310.0
Income	162.3	189.2	212.6	237.5	275.1	313.6
Balance	41.0	35.3	29.6	21.6	20.8	24.3
12 Percent of Outlays	20.2	23.4	26.2	29.4	33.1	37.2
Amount Needed to Bring Balance to 12 Percent of Outlays	—	—	—	7.8	12.3	12.9

SOURCE: Calculated from Summary Table 1, p. xii, Paying for Social Security: Funding Options for the Near Term, CBO, February 1981.

NOTE: Minus sign denotes a deficit.

---

[1] CBO's projected inflation and unemployment rates appear to fall about halfway between these two sets of assumptions.

BEST COPY AVAILABLE

These proposals would, in combination, also provide much greater savings than are needed to solve the long run Social Security financing problem, as projected by the Social Security Administration's Office of the Actuary. The total long run deficit would average 1.32 percent of total covered payroll over the next 75 years if the Administration's earlier Social Security proposals are enacted. (In 1981, 1.32 percent of covered payroll would be about $17.4 billion.) The new proposals, however, would save 2.86 percent of payroll, or over twice the necessary amount. One of these proposals, which involves changing the benefit formula so as to reduce earnings replacement rates for Social Security recipients with average earnings from about 43 percent to about 37 percent of their Average Indexed Monthly Earnings, would, alone, save almost all of the required amount.

II. THE ADMINISTRATION'S NEW SOCIAL SECURITY PROPOSALS

Most of the expected savings would occur as the result of proposals in one of three major categories. These are: (1) proposals which affect those who retire before age 65; (2) proposals affecting the disability program; and (3) proposed changes in the benefit computation formula. In addition, there is one proposal which would cost money in both the short- and the long-run: phasing out the earnings test for retirees over 65. The impact of the Administration's 13 proposals under their economic assumptions is outlined in Table 3.

1. Reductions in Benefits for Early Retirees

Under the three proposals which would affect those who retired before age 65, benefit declines would be very substantial. On average, those who retired at 62 after January 1982 would receive benefits that were about one-third lower than the benefits they would have received under current law, and less than half the benefits they would have received had they retired at 65. Total savings under the three proposals affecting early retirees would come to more than $20 billion between 1982 and 1986, under the Administration's assumptions.

The largest savings, and the largest declines in benefit levels, would result from the proposal to reduce the benefits received by those who retire at 62 to 55 percent of the full benefit level, rather than 80 percent as it is now. The current reduction for early retirement is designed to be actuarially neutral; that is, the total reduction in annual benefits is expected, on average, to be exactly balanced by the additional benefits received in the years before 65, so that total lifetime benefits remain the same no matter when retirement takes place. In fact, however, the current reduction is too small to be actuarially neutral, since only a very low

BEST COPY AVAILABLE

TABLE 3. COST ANALYSIS OF EFFECT OF VARIOUS SOCIAL SECURITY OPTIONS[a]
(In billions of dollars)

Item	Short-Range Effect CY 1982-86[b]	Long-Range Effect: Savings as a Percent of Taxable Payroll[c]
Status of Present System, Deficit	-$11.0(-110.8)	-1.52
Effect of Budget Proposal	25.5(36.8)	.20
Status of Program After Budget Proposals Enacted	(-74.0)	-1.32
Proposals		
1. Cover Sick Pay in First 6 Months	2.6 (2.6)	.02
2. Change Computation Points for Average Indexed Monthly Earnings from Age 62 to Age 65	1.3 (1.4)	.39
3. Increase Bend Points in Primary Benefit Formula by 50% (instead of 100%) of Wage Increases, 1982-1987	4.2 (4.7)	1.30
4. Benefit Rate of 55% of Primary Benefit for Retired Workers (and 27.5% for Spouses) at Age 62	17.6 (20.3)	.85
5. Eliminate Benefits for Children of Retired Workers Aged 62-64	1.9 (2.0)	.02
6. Disability Maximum Family Benefit Applicable to Survivor and Retirement Cases	2.9 (3.3)	.10
7. Eliminate Windfall Portion of Benefits for Persons with Pensons from Non-covered Employment	.6 (.6)	.10
8. Require "Medical Only" Determination of Disability (that is, exclude vocational factors)	7.7 (9.0)	.06
9. Increase Disability Waiting Period from 5 months to 6 months	1.4 (1.5)	.03

(Continued)

BEST COPY AVAILABLE

TABLE 3. (Continued)

Item	Short-Range Effect CY 1982-86[b]	Long-Range Effect: Savings as a Percent of Taxable Payroll[c]
10. Require Disability Prognosis of 24+ Months Duration (instead of 12+ months)	2.8 (3.4)	.07
11. Require 30 QC Out of Last 40 Quarters for Disability Benefits (instead of 20/40)	10.0 (11.5)	.21
12. Move Date for Automatic Benefit Increases from June to September (and use 12-month average)	6.3 (27.8)	.14
13. Raise Retirement-Test Exemption for Age 65+ to $10,000 in 1983, $15,000 in 1984, $20,000 in 1985, and Eliminate Test in 1986	-6.5 (-7.4)	-.14
Total Effect	46.4 (75.0)[d]	2.86

SOURCE: Press Release, Department of Health and Human Services, May 12, 1981, p. 6.

a. Positive numbers indicate savings; negative numbers indicate added costs or amounts needed to meet cost of present program).

b. In billions. Figures in parentheses are based on "worst-case" assumptions; other figures are based on the expected economic assumptions (those in the President's Budget).

c. Average cost over 75-year period, in percentage of taxable payroll.

d. Including effect of additional net income to Hospital Insurance program.

BEST COPY AVAILABLE

interest rate is charged for early payment of benefits. If the interest rate were raised to 10 percent, it would result in an early retirement benefit level which would be about 70 percent of the full rate. This rate would still be well above the proposed level of 55 percent.

In addition to the proposed reduction in benefit levels, two other changes affecting early retirees have also been proposed. These are, first, a change in the years which are included in the formula for computing Average Indexed Monthly Wages (AIME), so that those between 62 and 65 are counted, as well as those before 62, and second, the elimination of benefits for children of those who are retired and less than 65 years old. Moving the date at which AIMEs are calculated from 62 to 65 would mean that those who retired early would have three years of low or zero earnings averaged into their AIME, which would lower the base on which their benefits are calculated. It could also prove administratively complex, if some of those who retire early continue to have earnings, and so need to have their AIME's revised. The argument for the elimination of children's benefits for those who retire early is that it could remove what may be an incentive for those with relatively young children to retire early.[2]

Encouraging workers to retire later may have a great deal of appeal as a solution to the long-run problems of the Social Security system, since it would not involve reducing benefits for those who have retired. It should be borne in mind, however, that many older workers retire early either because of health problems or because they have difficulty in finding or keeping a job, and proposals to reduce benefits by a very large amount could create some hardship for those who must leave the labor force. A 1971 Social Security Administration study found that 54 percent of male early retirees left the labor force because of ill health, and another 20 percent left because of employment-related difficulties. As the health status of older workers improves over time, and the size of the younger labor force decreases, both the demand for and the supply of older workers will presumably increase, even in the absence of major disincentives for early retirement. In the short run, however, most of the savings associated with proposals to discourage early retirement by reducing benefits would arise from reductions in benefits for those with few options for continued employment, rather than from increases in the age of retirement.

2. Changes in the Disability Program

There are four changes in the Disability Insurance program included in the Administration's new proposals, in addition to the disability benefit cap and stricter recency-of-work test proposed in the budget. These proposals would, in combination, reduce DI outlays over the next five years by

---

[2] Since the family maximum is generally about 165 percent of the PIA, the additional benefit receivable by those who retire early and have children will in any case be limited.

BEST COPY AVAILABLE

about one-third. Three of these four new proposals would act to restrict eligibility for disability benefits. This would be accomplished by requiring that workers be in covered employment for 30 out of the last 40 quarters in order to be eligible (instead of 20 as at present); that only medical factors, and not age, previous employment, or skill levels, be considered in determining whether a worker is disabled; and that there is a prognosis of at least 24 months of disablement (or death within that period), instead of 12 months as at present. The fourth proposal would increase the waiting period for disability benefits to six months, from the current level of five months. These four proposals together would, under the Administration's assumptions, generate savings of almost $22 billion between 1982 and 1986. Most of the savings, over $20 billion, would result from the exclusion of workers who were not eligible under the new rules, rather than from restrictions in benefits for those who remained eligible.

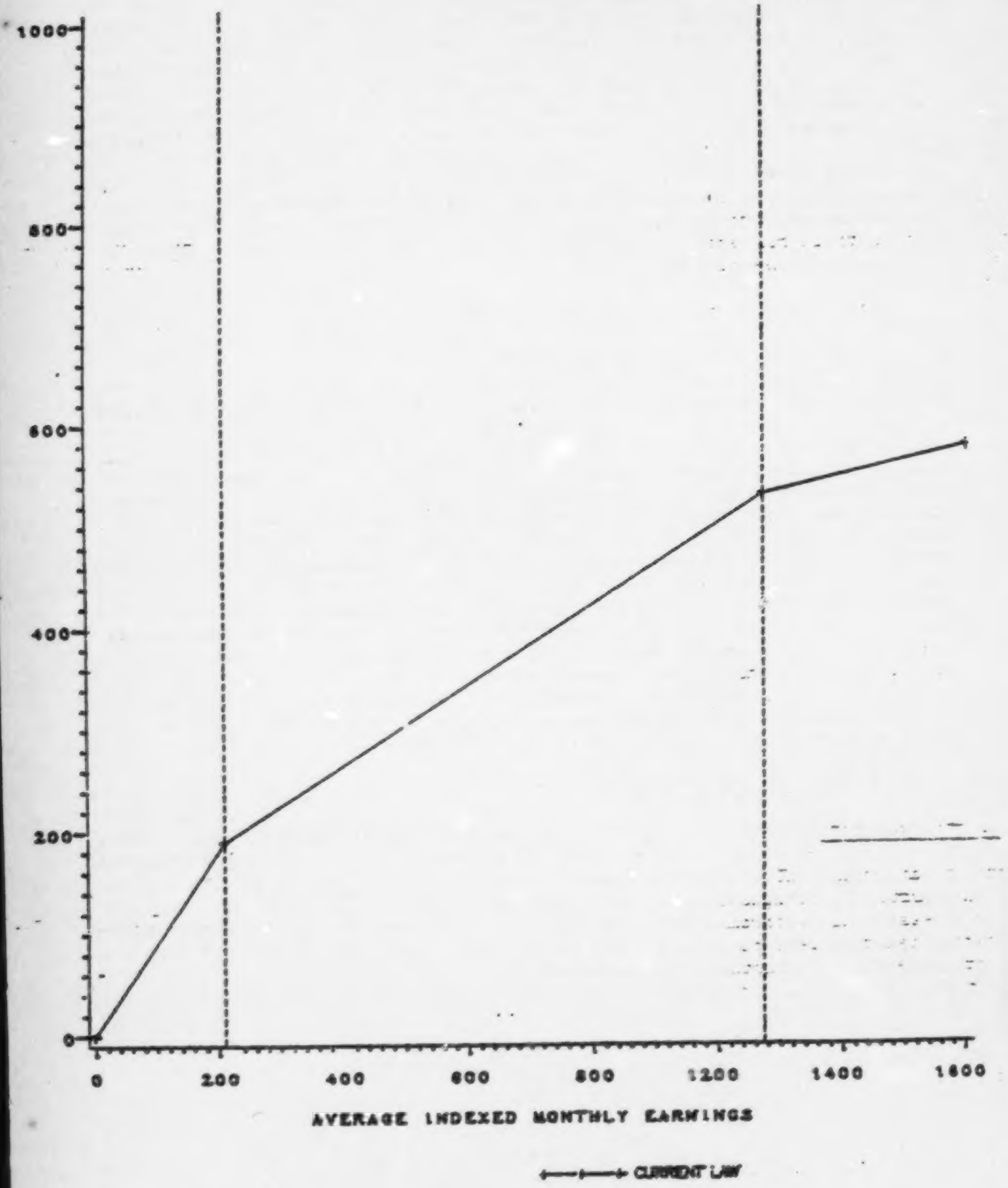
The three proposals to restrict eligibility could, in combination with the proposed benefit reductions for those who retire early, result in some difficulties for those with health problems who are between 62 and 65 years old. This group is particularly likely to be affected by the requirement that only medical factors be considered in determining disability; at present, over a third of those aged 60 to 65 who receive disability benefits have some nonmedical factors taken into account in determining their eligibility. The requirement of 30 quarters of covered employment out of the last 40 is particularly likely to affect those with progressive disabilities which have limited their employment opportunities. In addition, female workers who have spent over 2.5 years out of the last 10 out of the labor force due to home responsibilities would also be excluded, as would those who had experienced substantial periods of unemployment. There would presumably be some increases in outlays for unemployment benefits, food stamps, and AFDC, if these proposals were implemented. It seems unlikely that a large proportion of those who were excluded from eligibility under these proposals (probably about 1.25 million people over the next five years) would find employment; according to the Select Committee on Aging, 4 out of 5 of those denied eligibility for disability benefits under the present program never work regularly again.

3. Proposed Formula Changes

The third major proposal for Social Security savings would involve changing the formula that is used to calculate a worker's Primary Insurance Amount (PIA), based on his Average Indexed Monthly Earnings (AIME). As discussed earlier, when a worker reaches age 62, his average monthly earnings in covered employment over his entire work history are computed. For each year, his earnings in that year are indexed by the ratio of average covered wages in that year to average covered wages in the year he becomes 62, and then the average of these indexed amounts is computed (after dropping the five lowest years). Finally, this annual average is converted to a monthly amount, to arrive at the worker's AIME. In order

BEST COPY AVAILABLE

FIGURE 1
PRIMARY INSURANCE AMOUNTS IN RELATION TO AVERAGE INDEXED MONTHLY EARNINGS:
CURRENT LAW 1981



USING CBO PROJECTIONS OF GROWTH IN AVERAGE WAGES, 1981–1986

BEST COPY AVAILABLE

to compute the worker's basic Social Security benefit, a progressive formula is applied to his AIME. Under the formula, a very large proportion of the first part of a worker's average monthly earnings is replaced by Social Security benefits, but as AIME's rise, the proportion replaced falls (see Figure 1 for an illustration of the formula). For 1981, the formula is as follows: a worker's basic benefit (or PIA) equals 90 percent of the first $211 of his average Indexed Monthly Earnings, plus 32 percent of his AIME between $211 and $1,274, plus 15 percent of his AIME above $1,274. Thus, a worker with $1,300 in AIME would have a PIA equal to (.90 x 211) + (.32 x 1274-211)) + (.15 x (1300-1274)), or $533. A worker with a lower AIME would have a PIA that was a higher proportion of his AIME, and correspondingly, a worker with higher covered earnings would have a PIA that was a lower proportion of his AIME. The points at which the percentage replacement rates change (in this case, $211 and $1274) are generally referred to as bend points.

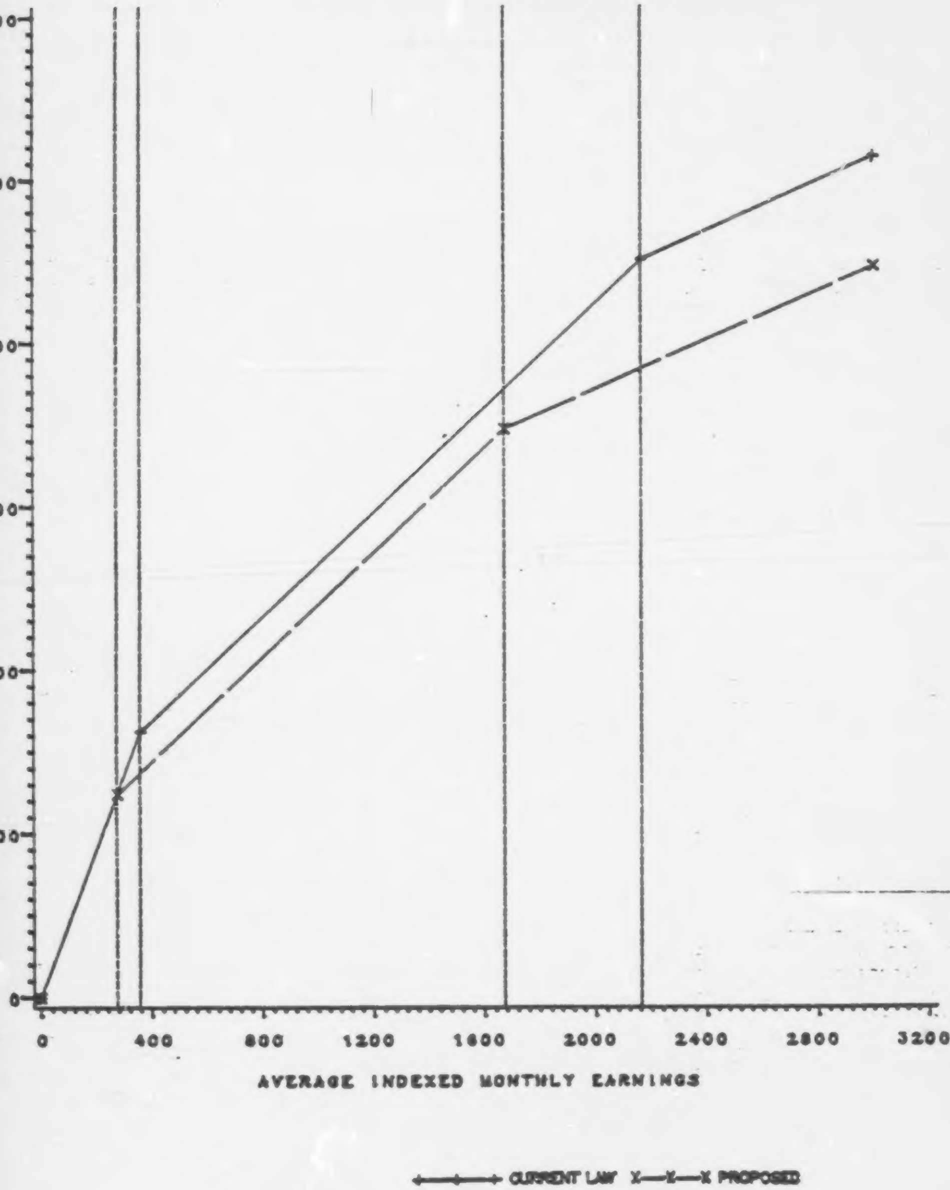
Under current law, these bend points are indexed by the change in average covered wages, so that over time the average replacement rate remains constant. The Administration's proposal is that the bend points should be indexed in such a way that, for the next five years, they rise only 50 percent of the proportion that covered earnings rise, rather than 100 percent. Thus, if covered wages rose 10 percent in 1982, the bend points would rise only 5 percent. After 5 years, this would result in the changes in benefit levels illustrated in Figure 2. For a new recipient with covered earnings in each year of his work history equal to the average for that year, the benefit received at age 65 would would decline from 42.7 percent of AIME, as it is now, to 37.9 percent after five years under the proposed formula. For someone with the maximum possible AIME for a retired worker, age 65 benefits would decline from 40.3 percent of AIME to 34.5 percent under the proposal (see Table 4). For those with AIMEs below the lowest bend point, however, there would be no decline in the average replacement rate, which would continue to be 90 percent. This proposal would therefore have the largest impact on those with relatively high benefit levels, and would not affect those with very low benefits at all. If full indexing were resumed after five years, average replacement rates would remain constant at the new lower level from then on.

4. Other Savings Proposals

The Administration's package contains four additional proposals. These are, first, a change in the timing of automatic cost of living increases; second, the coverage of the first six months of sick pay under the payroll tax; third, a reduction in Social Security benefits for those with pensions from noncovered employment; and finally, the extension of the family maximum benefit limit which was imposed on those receiving disability benefits under the 1980 Disability Amendments.

BEST COPY AVAILABLE

FIGURE 2
PRIMARY INSURANCE AMOUNTS IN RELATION TO AVERAGE INDEXED MONTHLY EARNINGS:
CURRENT LAW AND PROPOSED, AFTER FIVE YEARS



USING CBO PROJECTIONS OF GROWTH IN AVERAGE WAGES, 1981—1986

BEST COPY AVAILABLE

TABLE 4. REPLACEMENT RATES FOR THREE CASES, UNDER CURRENT LAW AND PROPOSED CHANGE IN FORMULA

Case		Year[a]	AIME	PIA	Replacement Rate[b]
Average AIME[c]		1981	783	373	47.6
	current law,	1986	1,330	633	47.6
	proposal,	1986	1,330	586	44.1
AIME at Average		1981	1,143	488	42.7
Earnings	current Law,	1986	1,942	829	42.7
(30 year	proposal,	1986	1,942	736	37.9
work history)[d]					
AIME at		1981	1,340	540	40.3
taxable	current law,	1986	2,276	917	40.3
maximum[e]	proposal,	1986	2,276	786	34.5

a. 1986 values calculated using CBO projections of the change in total wages, 1981-1986.

b. PIA as a percentage of AIME.

c. Approximate average for all retired workers in 1981 (and inflated to 1986 values).

d. 1981 AIME for a worker reaching age 61 in 1981, who earned the average covered wage in each year of a 30 year work history (and inflated to 1986 values).

e. Maximum AIME for a worker reaching age 62 in 1981 (and inflated to 1986 values). Actual maximum in 1986 could be higher due to changes in the taxable maximum as a proportion of average covered earnings.

The first of these proposals would move the date at which the annual Social Security cost of living adjustment was payable from July first to October first. It would also change the method of computing the COLA. Currently, the COLA is based on the rise in the CPI between the first quarter of the year in which the adjustment is made and the first quarter of the previous year. Under the proposal, the COLA would be based on the average change in the CPI over the preceding 12 months. Savings under this proposal would arise both from the postponement of the COLA for 3 months in the first year, and from the assumption that the rate of inflation will decline, so that an average of inflation rates over the last 12 months will be lower than the first quarter to first quarter change. Total savings under this proposal are estimated by the Administration to be $6.3 billion between 1982 and 1986.

The second proposal, to cover sick pay received during the first six months of illness, would result in some administrative simplifications, as well as producing additional tax revenue. Total savings under this proposal are expected to be about $2.6 billion over the next five years.

The third proposal, to reduce benefits for those with pensions from noncovered employment, is described the Administration as the elimination of "windfall" benefits for civil servants and other noncovered workers. It appears, however, that the size of the pension would not be considered in setting the benefit reduction rate, so that all those who had worked in noncovered employment would be affected equally, even if their pensions were very small. The proposal is that for those with pensions from noncovered employment, the benefit calculation formula should be revised so that the replacement rate would be 32 percent in each of the bottom two AIME brackets, instead of 90 percent in the first and 32 percent in the second. At 1981 bend point levels, this would mean a benefit loss of $122 per month for all those affected, if their covered earnings entitled them to an AIME of at least $211. The amount lost would depend only on the amount of covered earnings, with those with very small AIME's losing less than those with higher AIME's, regardless of the respective sizes of their pensions from noncovered employment. Thus, someone with a substantial period in covered employment, and only a very small pension based on a short period in noncovered employment, could be affected more than someone with a large pension from noncovered employment but only a short period of contributing to the Social Security system.

The final proposal would involve extending the cap on family benefits enacted for disability cases to those who receive benefits as retirees or survivors as well. The disability cap equals 85 percent of the worker's AIME, or 150 percent of his PIA, whichever is smaller. The rationale behind the cap for disability cases was that if benefits could be higher than previous earnings, it could create an incentive for those disabled persons who might be able to continue work to leave the labor force. The cap at 150 percent of the worker's PIA means that no disabled person can receive more than his own basic benefit (100 percent of his PIA) plus a benefit for his spouse or one dependent (50 percent of his PIA). This reduces the incentive for those with dependent children to claim benefits, and also reduces the amount dependents' benefits paid. The argument concerning work disincentives seems largely inapplicable to the extension of the cap to retirees and survivors, since for the most part their work effort will be unaffected by the relationship between previous earnings and benefits. If the cap were extended to these groups, it would eliminate children's benefits for most of those who retired at 65, and would reduce them to three-fourths of the benefit now paid for one child for those retiring at 62, if they also had a spouse who qualified for benefits. It would also reduce benefits for surviving children with a parent who also received benefits to the level of those now received on the behalf of one child or less if the surviving parent were over 61. This could result in some hardships for widows and widowers with more than one child under 18 years old.

STATEMENT BY
THE NATIONAL ASSOCIATION OF POSTAL SUPERVISORS
SUBCOMMITTEE ON SOCIAL SECURITY AND INCOME MAINTENANCE PROGRAMS
COMMITTEE ON FINANCE
JULY 10, 1981

Mr. Chairman and Members of the Subcommittee, my name is Maurice J. Twomey. I am Executive Vice President of the National Association of Postal Supervisors, an organization representing over 33,000 management employees of the U.S. Postal Service. With me is Andrew E. Ruddock, a former Director of the Bureau of Retirement, Insurance and Occupational Health of the U.S. Civil Service Commission, who is now a consultant to our organization.

We appreciate this opportunity to give the Subcommittee some of our views concerning financing options for the Social Security System. I will be brief. We will not attempt to discuss all of the possibilities but will concentrate on a few matters that are of greatest concern to our members.

We strongly urge this Subcommittee to reject any proposal that Social Security coverage be made mandatory for Federal and Postal employees. It is now generally recognized that imposing such coverage would not cure the financing problems of Social Security. But, it would be extremely disruptive to the Civil Service Retirement System.

We share the view expressed by Mr. Robert P. Bynum, then Deputy Commissioner of Social Security, when he stated, "Bringing Federal employees under Social Security would not reduce Social Security costs, and not slow planned future increases in the Social Security tax." In response to a question he stated that universal coverage would not relieve Social Security's financing problems.

Early in 1980, the Universal Social Security Coverage Study Group presented the results of its two-year, two-million dollar study. Mr. Joseph W. Bartlett, who chaired this group, testified before a Committee of the House of Representatives that cost considerations alone would not justify integration of the Civil Service retirement and the Social Security systems. We concur in this conclusion. Any immediate improvement in Social Security financing would be offset in future years as more and more public employees qualified for old-age and other benefits. Even the short range improvement would come in large part from general revenues used to pay the employer's share of FICA taxes for government employees.

For many years, the substantial amounts paid by government would be used to pay the retirement benefits of employees of other employers. Very little of the government's payment would be used to defray retirement costs for its own employees. In the meantime, much of the continuing cost of the Civil Service Retirement System would have to be met by the government. A requirement that Federal and Postal employees pay Social Security taxes at current rates would leave them with only limited financial ability to continue contributions to the staff retirement system.

There are no free lunches in retirement financing. The true costs of any retirement system are measured by dollars actually paid out in benefits, plus administrative costs that are usually negligible. If Federal and Postal employees were brought under Social Security and the Civil Service Retirement system modified so that combined benefits from the two systems were about equal to present CSR benefits, there would be no savings. The sources of income and the funds used to pay benefits might be rearranged, but over the long term, the totals would be the same.

For the record, let me state that the National Association of Postal Supervisors is unalterably opposed to mandatory Social Security coverage of Federal and Postal employees.

We believe it would be a serious mistake to legislate major reductions in benefits as a means of improving Social Security financing. In our opinion, a great majority of Americans would prefer some increase in taxes rather than the elimination, postponement, or reduction of benefits.

In the final analysis, the soundness of the Social Security system depends on the willingness of each generation of workers to be taxed in amounts necessary to pay the retirement benefits of the preceding generation. This willingness to be taxed stems in large measure from each worker having confidence that when it comes his or her turn to retire, benefits will be paid as promised by the laws under which he or she worked and paid taxes. Any major deliberalization of benefits for the present generation would gravely undermine this confidence. The next generation would have to anticipate the possibility of similar or even greater deliberalizations in the future. No one could make retirement plans with any certainty that benefits would be available at the expected time or in the planned amounts.

There is at least one other way the willingness of Americans to pay Social Security taxes at necessary rates could be diminished. This could happen if the financing measures -- either increased taxes or reduced benefits, or both -- were to go beyond what was absolutely necessary to meet immediate financing needs. This would create an impression they were being adopted primarily to help balance the Federal budget. The temptation to distort Social Security financing for this purpose is very great since for every dollar by which Social Security revenues exceeded outlays, there would be a corresponding reduction in the budget deficit. We believe it would be a major mistake to approve wholesale reductions in benefits for the purpose of balancing the budget. If that course of action were followed now, no generation of workers could have confidence that it would not happen again and again in the future.

If the Subcommittee decides to consider reductions in benefits, we suggest that it be done in ways that will minimize the adverse impact on individuals. Effective dates should be set far enough in the future so workers can adjust their plans to avoid inconvenience and financial hardship. Deliberalizations, if unavoidable, should apply only to future service. It is most unfair to change the rules and pay decreased benefits than those that were promised by law during the period in which the work was performed and the taxes paid.

Above all, we urge the Subcommittee to reject any options that would discriminate unfairly against Federal and Postal employees. One example where discrimination is clear and unmistakeable is the proposal to make Medicare a secondary insurer when the claimant also has coverage under a plan participating in the Federal Employee Health Benefits program. By law, Medicare has always been the primary insurer when the individual also has coverage under any other kind of insurance, whether it is a private policy or a group policy sponsored by an employer, a union, or some other organization. To reverse the primary-secondary roles when the other insurer is an FEHB plan would require Federal and Postal employees to collectively pay an estimated twenty percent increase in their health insurance premiums -- a burden not proposed for any other group of taxpayers.

The budgetary effect of adopting this proposal could be achieved more simply by levying a special tax on Federal and Postal employees with the proceeds being used to help finance the Medicare program. Obviously, such a special tax would not be adopted because its discriminatory nature would be transparent. To accomplish an identical result by switching the roles of primary-secondary insurer would be no less discriminatory.

This discrimination would be particularly pointed as it applied to Part B of Medicare, which is available without any requirement for quarters of Social Security coverage. None of the cost of Part B is paid from FICA taxes on wages. Instead, each participant pays monthly premiums, but these premiums meet only about thirty percent of the total cost. The other seventy percent comes from general revenues, toward which Federal and Postal employees have always contributed just like all other citizens. It would be most unfair to single out this one group, whose members contribute as much as any other group toward Part B financing, to receive less in benefits.

We realize, Mr. Chairman, that the proposal to change the present Medicare/FEHB relationship was removed from the budget reconciliation package during debate in the Senate. We are very appreciative of this action, but again want to state that this should not be reconsidered by this Subcommittee in your deliberations on Social Security financing options.

We are aware of the grave responsibility of this Subcommittee to initiate measures to assure sound financing of Social Security, and of the extreme difficulty of the task. As you proceed, we respectfully request that we be given an opportunity to study and to offer suggestions on specific legislation that contains all the details necessary for a full understanding of its effect on individuals.

We thank you, Mr. Chairman, for this opportunity to express our views on these important issues. We would be happy to answer any questions.

STATEMENT OF
INTERNATIONAL UNION, UNITED AUTOMOBILE, AEROSPACE AND AGRICULTURAL IMPLEMENT WORKERS OF AMERICA, UAW
BEFORE THE
SUBCOMMITTEE ON SOCIAL SECURITY AND INCOME MAINTENANCE PROGRAMS, COMMITTEE ON FINANCE
U.S. SENATE

July 10, 1981

The UAW is pleased to be able to present our view of the Social Security system. Our presentation covers matters related to the financial status of the Social Security system and the Reagan Administration proposals. Of course, we will be happy to respond to any questions about these comments or to submit our views on other aspects of Social Security.

The most important point to be made at this time is that, even without any changes in the benefit or aggregate tax rate provisions of the present law, the cash flow shortfall which the Trust Funds face in the next few years is only a temporary event. [1]

Without dismissing the longer term questions, it is evident that the near-term problem can be handled by inter-fund borrowing and relatively small short-term loans from general revenue sources or through small amounts of general revenue financing. Although the OASI Fund faces more substantial deficits than do the combined assets, the overall OASDI Fund's experience is the proper basis for evaluating the financial health of the system. The maintenance of separate Funds within the Social Security system, and the allocations of the tax revenue, are essentially record-keeping conveniences. When the three Funds are looked at together, it is clear that the situation is not one of great difficulty. As has been pointed out by the CBO, [2] the system's cash flow problems can be handled with less than $10 billion of "outside" money. [3/] To this end we endorse the House proposal to finance half of the health insurance program from general revenues and to shift half of the present health insurance premium to the OASI program. [4/] In short, the current crisis can be resolved with minimal impact. The dire warnings "to the leadership of the Congress that Social Security is 'teetering on the edge of bankruptcy,'" [5/] neglect to point out that the problem is a temporary cash flow one, centered in the OASI Trust Fund which can be handled with these relatively modest financial provisions.

---

[1] Although we have not yet had the opportunity to study the 1981 Trustee's Report, all indications are that the projections have not changed significantly from a year ago.

[2] CBO Study "Paying for Social Security: Funding Options for the Near Term," 2/81, pp. 21-22. Also February 17, 1981 testimony in front of House Subcommittee on Social Security.

Longer Term Problems

Over the last several years great concern has been expressed over the financial impact on the Social Security system due to the aging of the population. In terms of demographic developments and their overall impact, the fact that the increasing proportion of older people is due to a slowdown in total population growth seems to have been lost from sight. If the number of working age people were to grow as rapidly as in the past, the Social Security system would appear to be better off, but the entire nation would suffer the ills of rapid population growth. The slower population growth which is expected to continue actually will make it easier, in the 21st Century, to meet the needs of all people, including older ones. In that sense, the proportionately greater share of output which will go to older people is one of the consequences of the benefit of avoiding overpopulation. More resources will be available for the income needs of older Americans.

With respect to the longer term, the financial status of the Social Security system can be improved by phasing in general revenue contributions which ultimately would provide one-third of the financing. In addition, the maximum taxable wage base

---

[3/] Compared to over $1 trillion in benefits due to be paid over the ten year period.

[4/] We also support a refundable income tax credit equal to 20% of each employee's FICA payments. This would provide direct relief to taxpayers and would not decrease the flow of revenue into the Trust Funds.

[5/] Statement before the Task Force on Women and Social Security, House Select Committee on Aging, June 3, 1981.

should increase beyond the levels provided by current law (there should not be any maximum for determining employer contributions), to provide additional and more equitable financing, and also to increase the benefit entitlements which workers can earn.

We do not share the pessimistic outlook that our nation's economy in the 21st Century will be unable to support the current retirement age formula. As we and others have previously pointed out, we do not believe that it will be necessary or desirable to increase the retirement age (or to otherwise decrease early retirement benefits). There are other alternatives and broader social implications to be considered. We urge that those matters be debated in a framework which encourages consideration of the society-wide implications of the economy, changing population structure and the appropriate continued role for Social Security in the next century. Premature and pessimistic actions now would be comparable to having concluded in the 1930s that America did not have the capability of further economic growth. Progress over the next 50 years can easily be as great as — more likely will surpass — progress during the past 50 years. The point of all this which again must be emphasized is that the problems have been blown out of proportion. They are manageable and can be solved in a much more humane way than the Administration would have us believe.

The Administration's Proposals

In general, the Administration's proposals introduced a new degree of uncertainty regarding the reliability of Social Security benefit commitments. Prior to their presentation, there had been considerable well-grounded discussion of the short-term problems and the longer term changes which need to be addressed with respect to Social Security. While there is considerable difference of view as to the appropriate actions that should be taken, practically all knowledgeable persons agreed that solutions are available which are consistent with the American people's rightful expectation that they can plan their future with continued confidence in the social compact which has been embodied in Social Security legislation.

The Administration's proposals departed from this premise. Their proposal on early retirement benefits would be unnecessary even if it had been put forth on a longer-term basis, and is unjustifiable as a near-term action. Congress has already repudiated this proposal to "change the rules in mid-game" for those workers who have already left their jobs but are not yet age 62, and for those who otherwise would start collecting Social Security before age 65 in the near future. However, it is important that the debate not be narrowed to when such a change would take place. The real issue is whether it should occur.

The Administration also proposed to discourage early retirement by eliminating children's benefits in those cases, and by extending the earnings averaging period for three years. The latter change would reduce benefits even if retirement is at age 65, but would especially impact early retirees. These proposals, although less dramatic, have a similar impact to the reduction in the percentage of the full benefit amount payable in the event of early retirement. They reduce benefits and eliminate protections immediately for many workers near retirement age. These proposals should be similarly rejected.

The proposed cut in replacement rates, by curtailing the "bend point" increases, is simply an effort to reduce the value of Social Security benefits to all future retirees. Current replacement rates are not excessive. They were established by Congress in 1977 after long study. In fact, we believe they are too low. At present, Social Security does not assure even a satisfactory standard of living. Any analysis of retiree income needs, rather than of arbitrary cuts in budget levels for social programs, clearly argues against reducing Social Security.

Shifting the cost of living adjustment to October from July was originally set forth as a modest one-time adjustment which was to have little, if any, cumulative impact on retirees. As developed in HR 3207, there was to be a $700 million saving in fiscal 1982, and an almost neutral effect thereafter. In the Administration's hands that has grown to a $6.3 billion reduction in benefits for current and future retirees over the next five years. [6] If the cost of living date is shifted, there must be transition provisions which assure fair treatment for retirees.

The Administration's entire package of disability proposals — including those set forth before May 12 — reflect an overall desire to restrict those benefits, and a shot-gun approach to implementing that. In fact, benefits are inappropriately denied more often than they are inappropriately paid. There are now fewer disability beneficiaries (even though the labor force is larger), and a lower number of new cases than there were a few years ago when the apparent trend toward increased entitlement raised considerable concern. The disability program is not, as some would have us believe, out of control; thus whatever abuse may exist should be corrected very carefully and precisely, rather than by general cuts in eligibility and benefits.

Finally, it is ironic that the Administration includes a very expensive proposal to phase out the retirement earnings test for anyone over age 65. That would primarily benefit higher paid people, rather than the bulk of the American people who struggle to make ends meet. It is simply ridiculous to argue that the nation cannot afford to provide even inadequate retirement benefits to those who need them most, and at the same time to propose that anyone over age 65 will be able to earn as much as they want and draw Social Security. The retirement earnings test serves a valid purpose in distinguishing who is in or out of the work force and should be retained with appropriate updating, such as is already provided in the law.

These comments summarize our reactions to the major proposals in the Administration's package. Lack of comment upon others does not indicate lack of objection; in fact, we found little to agree with in the entire package, especially when we note that those proposals are cumulative with the cutbacks in Social Security contained in the Budget.

---

[6] A $27.8 billion reduction, on the pessimistic basis cited by the Administration.

We are also concerned about using Social Security cuts to balance the Budget. The simple fact is that the President's proposals provide much greater financial impact than is needed. Deputy Commissioner Myers (who is a former chief actuary of the Social Security Administration) has admitted that the long-term cost impact of those proposals would be twice the usual estimated actuarial deficit. Over the next five years, the disparity is even greater. In fact, if inter-fund borrowing was allowed, the Trust Funds as a whole would experience a short fall of only about $10 billion during all of the 1980s. Yet the Administration's proposals would cut benefits by $82 billion over the next five years. The additional $70 billion-plus becomes part of the Administration's plan to balance the budget at any cost. There must be a more sensible way to achieve this goal.

In conclusion, we urge that the Congress put Social Security issues in their proper perspective and to reject the Administration's proposals. Social Security is by far the most successful program — public or private — in the nation and must be enhanced rather than cut back. The public's confidence must be restored.

There are short-term problems, but they involve temporary cash flow matters, largely due to the recent high inflation and unemployment but aggravated by the maintenance of three separate Trust Funds within the system. Inter-fund borrowing, plus modest general revenue financing and/or outside borrowing, could take care of any difficulties that can reasonably be anticipated during the remainder of this century. The short-term problems are not due to and cannot justify imposing a penalty on current or future retirees. Even under the present benefit structure, Social Security payments for many years will be a smaller proportion of GNP than they now are.

The longer-term cost imbalance will have to be corrected. That cost will be manageable in an economy that undoubtedly will provide higher real income per capita than we now have, and which probably will not suffer from other more difficult population problems such as overcrowding. Providing a decent retirement income for older Americans will not impose a difficult burden on the economy; thus the focus should be on how the system will be equitably and adequately funded (including sources other than the payroll tax), rather than reducing benefit entitlements.

Senator ARMSTRONG. Ladies and gentlemen, we are pleased to call next to the witness table, a panel consisting of Mr. Lowell M. Jones, administrator of employee benefits, Firestone Tire & Rubber Co., and a member of the U.S. Chamber of Commerce. He will be accompanied by Michael J. Romig, director of U.S. Chamber Human Resources and Employee Benefits Section; Mr. Preston C. Bassett, consulting attorney representing the National Association of Manufacturers; Mr. John Re, staff tax administrator of the U.S. Steel Corp., and a member of the Council of State Chambers of Commerce; and Mr. James D. "Mike" McKevitt, director of Federal legislation, the National Federation of Independent Business.

Gentlemen, we are very pleased to welcome you here to participate in this media event. [Laughter.]

If you have charts, feel free to post them. If any of you have written books which you would care to advertise, please feel to include that in your testimony.

In all seriousness, we are very pleased to have you with us today and we look forward to what you are going to tell us.

Obviously the underlying purpose of this hearing is not just to hear one side of the issue or another, but in fact to foster and facilitate a healthy competition among competing ideas. So with that in mind, we welcome you and would like to call first on Mr. Lowell Jones.

Mr. Jones.

STATEMENT OF LOWELL M. JONES, ADMINISTRATOR OF EMPLOYEE BENEFITS, FIRESTONE TIRE & RUBBER CO., AND A MEMBER OF THE U.S. CHAMBER OF COMMERCE, ACCOMPANIED BY MICHAEL J. ROMIG, DIRECTOR, U.S. CHAMBER HUMAN RESOURCES AND EMPLOYEE BENEFITS SECTION

Mr. JONES. Thank you, Mr. Chairman. Good afternoon.

I am Lowell Jones, director of employee benefits, the Firestone Tire & Rubber Co. of Akron, Ohio. and a member of the U.S. Chamber's Employee Benefits Committee.

I am accompanied today by Mike Romig, director of Human Resources and Employee Benefits Section of the U.S. Chamber. We appear today on behalf of the U.S. Chamber of Commerce.

We are pleased to have this opportunity to present the business community's views on what steps should be taken to restore economic stability to the social security system.

I would like to summarize our testimony in just a few minutes remarks.

Social security is an example of a program that is living beyond its means. High levels of inflation and unemployment, in combination with lagging productivity and lagging real wage growth, have overextended the social security program.

This is becoming more and more clear to the American people. Trust fund levels have been drawn down to the point that, unless effective action is taken by Congress this year, the old age and survivors trust fund will be out of money in 1982. Should that happen, the Social Security Administration will be unable to issue monthly checks to aged retirees, their survivors and dependents. And that's a fact.

We believe it is imperative that Congress address both the short-term and the long-term financing problems facing social security.

The crisis can be met, and it can be met without increasing taxes, or resorting to the improper remedy of general revenue financing by taking the following steps:

One, require all Federal, State, and local government employees to participate in social security. That is to provide for universal coverage.

Two, put into effect, accounting and administrative changes to redistribute existing revenue in a manner designed to postpone the exhaustion of social security trust funds. In other words, specifically, interfund borrowing on a temporary basis should be authorized and temporary reallocation of FICA revenues on the trust fund should be implemented.

Three, modify the current method of indexation of benefits. Specifically, for example, index social security benefits to increases in the Consumer Price Index or wages whichever is smaller.

Four, enact the administration's proposals to modify certain benefits as outlined in page 12 of my testimony that has been presented with our statement.

These include some technical changes in the primary benefit formula and family maximum provisions, elimination of benefits for children of retired workers under 65, and several changes in the disability benefit provisions.

Five, amend, and then enact, certain administration proposals. The following administration proposals would be improved with certain modifications:

First, the proposal to reduce early retirement benefits. It is equally important to raise the retirement age from 65 to 68 to recognize increased life expectancy.

We would support full benefits at 68 with actuarial reduction for retirement before that age. Most importantly, however, we would propose implementing this proposal about 1990, and then phasing it in over a period of years.

Second, the proposal to move the date for automatic benefit increases from June to September 1982 and using a 12-month average. We recommend in addition that Congress modify the current method of indexation of benefits.

The proposal to eliminate the windfall portion of benefits for persons with pensions from noncovered employment, while we support this proposal, we recommend that the administration proposal be amended to provide universal coverage. That is, require all Federal, State, and local government employees to participate in social security.

If these recommendations are enacted, it will not be necessary to increase taxes or resort to the improper remedy of general revenue financing.

Rather than the $40 to $60 billion deficit, as now predicted, the social security system would enjoy a $94 to $114 billion surplus by 1987.

Our commitment as employers to the principles of social security, and the commitment of Congress as a responsible trustee for the retirement security of elderly Americans, should cause employers and Congress to work together for the enactment of the realistic program we are advocating—to save and strengthen social security.

That concludes my formal remarks, Mr. Chairman.

Senator ARMSTRONG. Thank you very kindly, Mr. Jones, for your testimony. I am confident that members of the committee will want to discuss your observations with you.

[Recess at 12:33.]

Senator ARMSTRONG. The committee will come to order.

Are there any motions to come before the committee?

We are awfully glad to welcome Representative Mary Rose Oakar, 20th District of Ohio; and my colleague Pat Schroeder from the 1st District of Colorado.

Thank you for coming and our apologies for the delay. We are eager to hear your testimony. I don't know yet what you are going to testify to, but whatever it is, you may be sure that it will be in agreement with what somebody has already said, but also will be directly diametrically opposed to what has been said by somebody. So if you can bring order out of chaos, please do.

STATEMENTS OF HON. MARY ROSE OAKAR AND PATRICIA SCHROEDER, U.S. REPRESENTATIVES

Mrs. SCHROEDER. Ah, democracy, isn't it wonderful?

We thank you for coming. I am here as one cochair of the Congresswoman's Caucus, which, as you know, is a bipartisan group. Several years ago we looked at some statistics that were devastating, concerning the feminization of poverty. The fastest growing poverty group in America today happens to be female.

We are here admitting that we are biased, on that issue. We took that whole issue up as one of our very major focal points in the caucus. We formed an institute. We started doing all sorts of research on it and became more and more horrified by what we were seeing.

In fact, if you look today, you find that almost all the gains in the war on poverty have not been female. Women are only moving faster and faster into poverty; and many Government agencies are now saying that is one of the biggest issues that we have to deal with.

Social security is a very basic problem We have looked at it as a caucus from a whole range of issues. Discrimination against women by the social security system, which we would certainly like to see taken away; and, how it affects the elderly.

As we look at the statistics right now, about 4.1 million elderly women have as their only income the social security check. The average check is about $6.95 a day

Now I realize we do more with less, but that's awfully tough. When you look at this elimination of the minimum benefit, we find that it adversely affects older women because three-fourths of the beneficiaries are women.

I made my main focus pensions. Mary Rose Oakar, who I am here to introduce, made hers social security. So she is much more current on what is going on.

One of the main focuses of the caucus is that we do not want to pit the old against the young. That would be the worst thing we could do in America, and I really resent hearing people even talk about that. We are here talking for the caucus and for this issue. With that I defer to our expert who has really put the time in. Mary Rose.

Ms. **Oakar**. Well, thank you very much, Congresswoman Schroeder, and thank you, Senator Armstrong, for the opportunity to appear before you today.

I am just wondering, I understand we have a—you will pardon me, Senator—a vote, and I, if it's the final passage, we will just proceed and tell our constituents why we missed the vote—they might prefer to have us here.

Senator, I certainly appreciate the opportunity to appear before your committee, and I had the very fine experience of being with you on a program not too long ago. I would like to submit my entire testimony for the record.

Senator **Armstrong**. Thanks you for doing so, we will be happy to have it in the record.

Ms. **Oakar**. Thank you, Senator. I am appearing as Chair of the Task Force on Social Security, the Aging Committee on the House side and certainly as a member of the Congresswoman's Caucus. We have had, as you know, numerable hearings on the issue of social security.

We really feel that the benefits paid to the American people are not only their earned right, but their legal right. It is no wonder that there is so much outrage by the elderly and by disabled people.

My remarks will address the recently released 1981 trustees' report, the refinancing proposal, and the current status of women under the program. In brief, it is my belief that the dire and the pessimistic projections appearing in the press release of the trustees report are indeed flawed.

They have additionally had the potential of forcing Congress to act prematurely as I think we did with respect to Gramm-Latta in the Senate-side of the budget. I would also like to request that this committee carefully scrutinize all refinancing proposals for their impact on older women in particular who are, as Congresswoman Schroeder said, the fastest growing poverty group in the Nation.

Let me address, very briefly, the trustees' report. The report, which was released July 6, projected short-term and long-term balance in the individual and aggregate trust funds using the administration's optimistic and worst-case forecast, in addition to the traditional economic assumptions.

Traditionally there has been a document that used three economic projections. The report used five. In an addition, although the trustees, as we all know, are members of the President's administration, the document in my judgment was never used politically to endorse President's legislative proposals.

Also curious for me is the timing of the report. Which, as you know, Senator, was due in April but came out after Gramm-Latta passed in the House which had dramatic cutbacks in social security. Then passed in the month of July before we have a chance to vote on the budget conference report. And I hope we do have that final chance to vote on the conference report.

I think the most startling feature of the trustees' report is its overemphasis of the worse-case scenarios and its preoccupation with the status of the Old-Age and Survivors Trust Fund rather than the combined totals.

The Congressional Budget Office issued its projections as recently as June 16. The CBO concluded that (1) sufficient reserves will remain in the old-age and survivors program up to the beginning of 1984, (2) the Disability Trust Fund will improve its position substantially through 1986 with reserves increasing to 132 percent of outlays, and (3) the Health Insurance Trust Fund balance will grow to over 80 percent of annual outlay over the next 5 years.

Of these three trust funds, only the Old-Age and Survivors Trust Fund is expected to experience a cash flow problem within the next several years.

The CBO also projected the aggregate trust fund balance as a percent of outlays under alternative economic assumptions. Both assumptions forecast real economic growth in each year over the coming 5-year period; no further downturns in the business cycle are forecast, which of course would have a tremendous effect on the trust fund's condition.

Under these assumptions, a surplus is projected in the combined trust funds up through 1984.

The extremely pessimistic projections of the trust fund's report must be considered in conjunction with the more positive projections of report such as CBO. But even if we accept the trustees' projections, there is a real question about the accuracy of their projections based on their internal data.

In short, in my judgment, if you take a look at the combined trust funds, there is no immediate crisis. I think, to be very honest, we are being irresponsible when we cause the great anxiety to our older Americans and our disabled Americans who paid into this system.

The chairman will note, the surpluses using different economic assumptions, including Reaganomics, and we have included for the record, two tables prepared by the staff of our Aging Committee Subcommittee on Retirements for your perusal.

One of the questions that we asked in the Congresswoman's caucus, Senator, pardon me—Secretary Schweiker, was why when they are projecting social security they use the worst case scenario. But why when they are projecting the tax cuts proposed by the administration, they use Reaganomics which is more optimistic. We feel that fair is fair.

We ought to be using the same kind of economic projections for each case.

I did not support Gramm-Latta and I really feel that it has devastated the social security system in terms of its cutbacks. But if you based on these proposals, you will have a tremendous increase in the Trust Fund if those proposals go through. By the end of 1985, under these economic assumptions used by the administration, the trust funds would increase positively by $26.3 billion to about $69 billion. Even under pessimistic assumptions, the Trust Funds will increase by $2.7 billion—not go down as some would have you believe. Furthermore, one of the things buried in the trustees report that didn't get any kind of publicity was the fact that if you take a projection over 25 years, according to their report, you would find a tremendous surplus of at least 17 percent.

This is due to the so-called baby boom population after World War II who will be paying into the system.

We have some ideas about refinancing which are in my report, but I won't go into it.

But, I do want to get into two other issues that I think are especially important. One is the idea of interfund borrowing. I believe that this is the first issue that we ought to address for the so-called short-term deficit that may be found—I emphasize may—in the old-age and survivors insurance program. We should not, at this time, act on any long-term proposals that involve drastic program changes.

Even under pessimistic projections, interfund borrowing between the Old-Age Disability and Hosptial Insurance Funds would solve most of the short-term problems and additionally have the potential of solving long-term problems as well.

Current congressional proposals would give authority to the funds to make loans to one another whenever one of the funds falls below 25 percent of the amount of its disbursements for the 12-months preceding the borrowing.

Interfund borrowing has been supported by a variety of social security experts. We had all three former Commissioners who worked under Republican and Democratic administrations telling us that this was the easiest way to solve our current problems.

But the point that I guess I want to stress the most, Senator, that I feel very very strongly about is the fact that we ought to remove the trust funds from the unified budget. Keeping the trust funds under the unified budget perpetuates the dangerous illusion among the people that social security expeditures are part and parcel of other Federal expenditures based on general revenues. The dangers presented by including the trust funds in the unified budget should be obvious. It exposes the social security program to blatant manipulation by persons who would use the funds for a quick fix to balance the budget.

We know that David Stockman has said that he needs about $110 billion over the next 3 years to balance the budget. In addition to what they already will be getting with Gramm-Latta in your version on the Senate side. I don't think it is fair to our people who have paid into the system to keep using the trust fund to balance the budget.

If we are honest about it, that's what has happened. If we are honest about it, we know that in the Ways and Means Committee on the House side when they were figuring-out how they would meet Gramm-Latta, they drew into that trust fund and recommended some cutbacks that eventually, unfortunately did pass and we see that, indeed, whether we like to admit it or not or whether we want to be honest about it or not—the fact is that the trust fund is being used to balance the budget. As Robert Ball, who was the Director of Social Security under Presidents Kennedy, Johnson, and Nixon, said this decision was probably the greatest mistake made in the development of social security.

As you know, it was included as part of the unified budget for the first time in 1969. It was never intended to be part of the overall unified budget.

What about then the impact on women? Well, the fact is—and we feel just as strongly about the impact on older men—but the fact is that this is indeed in many ways a women's issue, that 72 percent of all the elderly poor are women. And as Congresswoman Schroeder has said, this—to be a female and old is to be poor. We know that the cuts in social security that are being proposed that are part of the Gramm-Latta substitute for our version of the budget indeed does include tremendous severe cuts that will affect, in general, the older women of our country.

I want to put, for the record, Senator, my six bills that I have introduced to correct what I consider the inequities of this system to begin with. What we do when we cut back on social security benefits is further these inequities in the system.

Let me just briefly go through the cuts that have been proposed in our part of the Gramm-Latta bill that Congresswoman Schroeder and I are most familiar with.

The Gramm-Latta elimination of the minimum benefit falls most heavily on women. By cutting approximately 40 percent, we know that 85 percent of the people affected by the minimum cuts—these cuts happen to be women. And that two-thirds of these recipients are between 70 and 90. Uncommon to what is commonly told publicly, these people, only 12 percent of them have another pension. They are not the double dippers that we always hear about. These are people that depend indeed on this minimum benefit. I personally think that is one of the most cruel harsh cuts we could ever think of. And, I am ashamed that it passed.

Also, the Gramm-Latta elimination of postsecondary student benefits. Last year 32 percent of all the benefits went to families with incomes under $5,000. Most of these families were headed by widowed mothers who will lose their main source of opportunity to send their students, their children to college.

The proposal to reduce benefits for future and early retirees again fall most heavily on women. These are the widows of our country, these are the mothers of our country. The proposal to reduce through the addition of 3 more years of the retirement computation period will again adversely affect women who combine home making and paid work rules.

Do we want to penalize women who are staying at home and having children and then going in and out of the labor force to assist in bringing up their family?

Is this what this Congress wants to do when we are supposed to be a profamily Congress? That this is the keystone of what the administration has told us. The administration proposal to increase the number of years needed to qualify for disability benefits and the use of medical standard only for determining eligibility will potentially disqualify more than 15 million women now eligible for their benefits.

It should be noted that we feel to begin with that the law is discriminatory by having the 5-year requirement because we know that women go in and out of the labor force and thereby lose their potential for disability.

You know, we could go on and on and on. The elimination of the death benefit, which some people say isn't necessary for older people. Well, that is really not true. Older people want a dignified retreat from this world. They don't want to be a burden on their children or their grandchildren. They count on that benefit. They do indeed make contract with an individual so that they can have a dignified retreat from this world.

In sum, any proposal to refinance social security which entails benefit cutback almost certainly will disproportionately affect women. It is they who can least afford any reduction at all in their retirement income.

It is our collective responsiblity to insure that this vulnerable group is protected.

When I say vulnerable group, I am talking mothers, I am talking grandmothers, and I am talking about great grandparents who are suffering because of the reduction of the minimum benefit.

In addition, there is no need for social security cutbacks if we solve our short-term problem by interfund borrowing. Proper assumptions must be used, not worstcase scenarios used to induce blind panic among our social security insurance program and its recipients, which has been viable since 1935.

I urge this committee to use objective statistics and to seek various points of views when evaluating the social security system.

Thank you for your indulgence in listening to us, but we felt it was very necessary to come to your hearings and we are glad that you could include us. Senator, thank you very much.

Senator ARMSTRONG. Thank you. We are grateful for your insights, and I can assure you with confidence that we are going to be attentive to a variety of points of view. In fact, the committee has heard testimony that roughly ranges from "Don't worry about it; things are fine" to "The sky is falling."

I was particularly interested in your comments about taking the Trust Fund out of the unified budget. That's a matter to which I think we ought to pay some attention. As I understand it, it was put in the unfied budget about 15 years or more ago. I don't know exactly what the legislative history of that is, but that's something that we will look at.

I have one question that I wanted to raise—or actually two—which were not addressed in your testimony: I am interested in your thoughts about the proposal, which I understand Congressman Pickle has proposed in the House, and which we have heard over and over again here, to phase in an age increase over a long period of time. Is that something that your group has considered?

Mrs. SCHROEDER. We have considered it. I don't think our group has taken a position. I can speak on it personally, and Mary Rose may want to speak on it personally.

I think one of the big problems is, again, the status of working women. You find that people in this country tend to marry men who are older than they are. So if the male is going to retire at 65 and the woman is 62, and she thought she could retire at a lesser amount to then be home, it may cause all sorts of problems.

There is also a lot of other problems affecting the unemployment factors. I have talked to many many employers, especially in the manufacturing area, who say that they made that decision a long time ago. It was better to open up the doors to younger people and to pay a little more to have people retire at 62 because they were tired. It is a little different than our jobs where we sit in nice air conditioned buildings.

I don't think you cut out that option. I personally don't think that Mr. Pickle looked at that quite hard enough as to what it does to women as they phase it all up and put it across the line. I think it is much better to say, if you go out at different times, you get different amounts. But allow people to choose the option that fits their lifestyle.

Senator ARMSTRONG. What you have just suggested—that is, people having flexibility but different amounts at different times—seems similar, for example, to what AARP has suggested.

The question then arises of whether the differential based on different dates of first retirement should be an actuarial assumption, or whether it should be something else. In other words, if you retire early, should you get more in total for retiring early, or should it be keyed to average life expectancy? What is your thought about that?

Ms. OAKAR. Senator, right now it is reduced, as you know, if you take the 62 benefit, by 20 percent. I don't think it should be reduced any further. That's your penalization. We have found——

Senator ARMSTRONG. That does result actuarially, however, in people who retire at 62 receiving more than if they retired at age 65.

Ms. OAKAR. No, if I could just—if you wouldn't mind my assumption. And, our studies have found that quite honestly it is just the opposite. That most people who take the retirement benefit at 62, many of whom happen to be women, live to the age of 78 and they would have been much better off waiting until the 65th year. I did want to comment on Chairman Pickle's proposals though personally if I could.

I think you were—were you referring to the phase-in of raising the age to 68?

Senator ARMSTRONG. That is what I was asking about first. But, I am advised by staff that there are not just two opinions on the question of whether or not the current reduction to 62 is actuarially correct. I thought there were two.

Senator Moynihan has stated repeatedly that if you retire early, you get no more than you would get if you retired at 65—that is on the average—which I believe is your thought.

My understanding was that you got more by retiring early, and staff now advises that a third point of view is that it is actuarially correct.

Senator MOYNIHAN. May I just say, Mr. Chairman——

Senator ARMSTRONG. I think I have waded into a quagmire here. Senator Moynihan, could you lead me out?

Senator MOYNIHAN. Yes. Commissioner Myers, who is now the Deputy Commissioner, made the judgment in 1962 when early retirement was agreed to—because we are often wrong in these matters, it is nice to report that there is something where we were right.

President Kennedy, I was at the Labor Department at the time, wanted to soak up some unemployment. Hence the early retirement policy. Mr. Myers was then key actuary and he said 80 percent of full benefit at 62 would even out actuarially. And from experience, this does just that. It does follow a differential impact on——

Ms. **OAKAR**. But, Senator, as you know though, the reason so many people take it at 62 beyond those who have planned ahead is because something happens in their life. They become——

Senator **MOYNIHAN**. Oh, we have pretty good numbers from HHS about this. About 55 percent of them are ill. And, of those, a very large percentage probably have no income at all. They are not working, but at 62 become eligible for this benefit.

Mrs. **SCHROEDER**. I think that's right. The Congresswoman's Caucus' concern is if you set the age at 72, 68, 65, 62 and say that is it, no one can retire before that age and do away with the differential.

Senator **ARMSTRONG**. I am lost. I don't want to argue it because I am not sure where I am going to come down. I couldn't hold up a point of view on this. But, are you saying on balance then that you want to just leave it the way it is or that it ought to be actuarially sound wherever that number?

Ms. **OAKAR**. I would like to leave it where it is.

Mrs. **SCHROEDER**. Leave it where it is and we feel that it is actuarially sound. We don't feel that that's been proven incorrect.

Senator **ARMSTRONG**. Senator Moynihan.

Senator **MOYNIHAN**. I would like to just continue the conversation I have been hearing.

Senator **ARMSTRONG**. Of course.

Senator **MOYNIHAN**. I think it has proved to be that Mr. Myers made a professional judgment, and it turned out to be right.

I would like to just comment on a couple of things that our colleague said here and tell you about some of the testimony that we have had.

To Congresswoman Schroeder, yes the experience of poverty in this country is becoming the experience of women and their children.

We have already in this committee and the full Senate, and you have done the same on your side, very sharply reduced payments to aid families of dependent children.

We ripped out of the social security law the title that looked after orphans and children in foster care—we just don't have that anymore. It was begun in a fashion in 1935, but now we cannot afford to take care of orphans.

The data on poverty are now very clear and they are overwhelming. Poverty can be found in aged women or in women in one-parent families.

We did some numbers last year—which I'll send to both of you. We worked out a formula which would accurately predict the historical experience of the number of children who have lived in a female-headed family and as a proportion, children who have lived and who will live in a family on ADC or AFDC before 18.

We go back to 1940, 1960, and 1970—and make projections for 1980.

We projected that 51 percent of the children born last year would be in a female-headed family before they are 18. And 32 percent would live on public assistance.

After all this effort, you know we have put a lot of effort into this thing in the last century—we end up with the prospect of one-third of our children will be on public assistance.

Much effort, but it happened.

Mrs. SCHROEDER. We appreciate your comments on this, Senator Moynihan. I think that's one of the biggest worries of the caucus. And those voices aren't heard in these wonderful light buildings. They really can't pay attorneys or people to come here and present their cause and do charts and all of that.

Senator MOYNIHAN. No orphans telephoned.

Mrs. SCHROEDER. No, there are no orphan PAC's and there are no——

Senator MOYNIHAN. No, I haven't got a penny out of them.

Mrs. SCHROEDER. I think it is a great concern because I think that we are pretending we are operating with the Norman Rockwell vision of the family which I love—but it doesn't apply but to about 17 percent of the families in America.

That's why the caucus wanted to come over here and keep emphazing wait a minute before we all get caught up in the charts, let's put flesh and blood on this. And look at what we are doing.

Senator MOYNIHAN. Who are these people?

We had a figure yesterday—Mary Rose, you would be struck by it. Carol Burrows Rosen, who is the president of the Women's Equity Action League, testified that—this is a striking figure—I am not sure it is right—but if it's right, it is startling—that 70 percent of women over 65 are or will become widows living alone for an average of 18 years.

Ms. OAKAR. That's right; 72 percent actually.

Senator MOYNIHAN. Is that right? Is that 18 right? Wow!

That is extraordinary. And a new experience—that's new to the race.

Ms. OAKAR. Senator, you know the problem when we reduce the minimum benefit by 40 percent and you are told that those people will go on SSI. You know, and I know, that you know to come up with just having $1,500 in value. I mean immediately eliminates most of our older people because they have some kind of means.

In addition, older people very seldom apply for those benefits because they are not into receiving the kinds of programs they ought to receive; and I really question where the morality is in what we are doing when we say that we can reduce a benefit $122 for 70 to 90 year olds down to $80 and sometimes $70 a month and expect people to live on that in 1981.

I guess this is our message, and my message is——

Senator MOYNIHAN. Could I just say one thing to you? This is not politicking. You are not supposed to say these things but, you know in the middle of this bill there is a proposal for liberalization.

We are not mad at anybody—part of the proposal cuts down the benefits of 90-year-old women who came in at $122, will get them down to $68—yet in the middle of this proposal is a raise in benefits for those persons, typically professional, who at 65 are still rolling along, never going to retire if they possibly can—we know plenty of people like that. They are lucky people. They have good jobs and they will never retire. They make more money at 70 than they made at 60, and more at 60 than they made at 50. Those people will have their benefits raised by about $3 billion a year.

Ms. **Oakar**. That's right.

Senator **Moynihan**. It can't be because of need. You might say equity if you want—but I don't see it. I think that is very questionable. This is an insurance program that insures you against loss of income. But professionals with earnings will have benefits that go up.

Now, who are they in terms of social class? Who are the people we are taking from and who are the people we are giving to? That's a class bias in this legislation. The most extraordinary thing I have seen since I have been in Congress. I didn't think we did things like this any more.

Thanks to the two of you, we are not going to do it. And thanks also to our chairman. He might be tempted in the wee hours of the morning, but after a good night's sleep he gets up and he is a good American again. I also forgot about me.

Ms. **Oakar**. We know the chairman is openminded on this issue.

Senator **Armstrong**. All Coloradans are, aren't they, Pat?

Mrs. **Schroeder**. Right.

Senator **Armstrong**. I am not sure this is the moment to speculate on what might happen in the wee hours of the morning. But I will tell you that the Senator from New York is a good American in the wee hours of the morning and the rest of the day, too.

I am confident, based upon the spirit of open mindedness and scholarship which he brings to bear on us, that after he has thought it through carefully, he perhaps will not resist so strongly the idea of taking off the disqualifying provision of the present law that permitted people not to work.

I think there are a lot of people in his State who feel that they have paid into the system, are entitled to collect the benefit, and shouldn't be disqualified just because they continue to work. But that's perhaps a discussion for another day.

Senator **Moynihan**. And one in which you can be open and deep. It's just that in the context of cutting the benefits that poorer people receive—to raise the benefit to people of some—needs is wrong. It is the context.

Senator **Armstrong**. It really comes down to a question of whether or not you think social security is a welfare scheme and ought to be based on need, or whether or not you think it is a program of social insurance, which if you pay into, you ought to get benefits back. That's a legitimate question.

That's really the essence of the issue. You are saying that even though somebody pays into it for a lifetime, if they still have earning power—they shouldn't receive benefits.

Ms. **Oakar**. Senator, if I could just—during the debate in the 1930's over social security, the fundamental principle of the system was to provide economic security for people who were potentially disabled and/or elderly. I think this is really the question. And really and truly, and, I respect you greatly, but to call or to imply that it's a welfare system when people pay into this system, and this is why that trust fund has no business in this budget. It is really——

Senator **Armstrong**. I think it is not a welfare system. That's my point. I think the essence of it is that it has always been conceived of as a system of entitlement that you pay into and get payment back out of as a matter of right.

What Senator Moynihan is arguing is basically that it ought to be a needs-tested system, at least in part—because if you continue to earn, you are disqualified. And that's just a difference in a point of view.

Mrs. **Schroeder**. Let me just say whenever you start categorizing, because of our history and tradition and the way laws were written, we often get into a lot of trouble.

For example, I don't think any country puts out more rhetoric on how we love mothers, and we love Mother's Day, and we send cards, and all sorts of things. However, we don't count anything they do in the gross national product, and unless they happen to be married and some derivitive benefit, they don't come into social security. and so forth, and so on.

We don't like them that much. To say to them well, this is welfare. My first question to you——

Senator **Armstrong**. No, no. Senator Moynihan says it's welfare. Pat, I'm saying that I like mothers so much that if it so happens that mother wishes to continue to work after age 65 that she shouldn't thereby be disqualified from receiving the social security payments that she may have paid into for a lifetime. Or father either.

Mrs. **Schroeder**. Because, what you don't want to do is get in a position where you are saying to the mother, "If you stay home and take care of your children, then to get enough credits in the real world, you are going to have to work longer."

Senator **Armstrong**. That's a completely separate issue. What Sentor Moynihan referred to is the proposal, which I fully endorse and have been backing for years, to take off the earnings limitation for people who are retired and drawing social security benefits. Now, that says nothing about how they got the benefits, or the level of those benefits, or how they qualified. I'm just saying, if you are entitled to benefits, those should not be taken away from you simply because you opt to continue to work.

Ms. **Oakar**. Well, I agree with——

Senator **Armstrong**. Can I ask one other——

Mrs. **Schroeder**. We don't have any problem with that, but we want to make sure that to make sure people get the maximum——

Senator **Armstrong**. You agree that the present limitation should be eliminated.

Mrs. **Schroeder**. That's right. Because——

Senator **Armstrong**. You see, Senator Moynihan, you see.

Mrs. **Schroeder**. That's right, because if you have windfall profits, you are all right.

Senator **Armstrong**. You see. I am sure that in the dark of the night when he is a good American, that Senator Moynihan is going to come to exactly the same conclusion. [Laughter.]

Mrs. **Schroeder**. But, Senator, I think you are misinterpreting and you are trying to do something here and play a little game.

If you look at our testimony, we are not even dealing with that issue, we are dealing about the very significant type of people——

Senator **Armstrong**. Oh sure, I agree that's a separate issue.

Mrs. **Schroeder**. And, I think that's where——

Senator **Armstrong**. But, somehow Senator Moynihan raised that issue, and that's why I was responding to it.

I want to ask one other question though if I may. This is, I think, not addressed in your testimony either. But it is a question that has come up repeatedly this morning and earlier this week.

Several witnesses have urged this subcommittee to do something that it has been loathe to do in the past, I am told, and that is to include Federal employees in the social security system. Has your group taken a stand on that, and how do you feel about it?

Mrs. **Schroeder**. Let's see, Mary Rose and I have studied this intensely because we both are cochairmen on the Civil Service Committee. But she oversees the retirement section and has done the most analysis of that.

Ms. **Oakar**. Well, Senator, we have—our committee hasn't taken a stand on it, but we will have hearings. But let me just say this, contrary to public belief, we have no guarantee that if you include Federal employees whose benefits are taxed as you know, unlike those who are social security recipients, that this, in fact, would help the trust fund. We think it might even hurt the trust fund. And we have some evidence to show that if you did lump them all together, in fact, it would place a burden on the trust fund.

I heard the chamber of commerce's testimony and the show that you and I both were on some weeks ago, we had one gentleman who was very very forceful in presenting that argument.

But the other side of the argument is that I don't think it would help the trust fund, at least not at this juncture.

But it is still something that we are taking a look at. But, at this point I would say that I don't feel that they ought to be included. Comparing apples and oranges, you are comparing what they pay in is somewhat different than what is paid in with social security recipients. They pay taxes on their benefits, social security recipients do not. The benefit structures are very different and even the implementation of that would cost the Treasury tremendous amounts of money.

So if you think that that would help the trust fund, I think we are making a little bit of mistake.

Mrs. **Schroeder**. If you look at the history of what's been done, it's whenever we get in trouble you would go out and look for some new unsuspecting group and drop a net over it and figure "Hey, they'll pay in for a while." But it has always been a short-term payout.

What they forget is, that group also then becomes eligible for benefits. I don't think that's ever worked.

Senator **Armstrong**. I appreciate your observations. I have generally agreed with what you have said about this, but I believe you are the first witnesses to express that point of view. Everybody else has been on the other side.

Senator **Moynihan**. No, don't worry too much. While there are any Congressmen who have any Federal employees in their district, there is no great chance that this would happen.

May I just take one second just to make a distinction so that the public can determine a logical distinction made in this hearing.

I don't know much. But I know the history of the Social Security Act. Martha Derthick has written a brilliant book about it. And I think we have used the word insurance, Mr. Chairman, in two different senses.

There is the kind of insurance that you could call life insurance. A system of pay-in and get-back and get an annuity. And in the meantime it is protection against unexpected death.

That is a sort of savings.

There is another kind of insurance which, if you are lucky, you never collect. Because it takes care of you in the event of some kind of misfortune—ranging from misfortune to calamity.

The Social Security Act is that kind of insurance. You are lucky if never in your life you collect a day's aid to dependent children. That's a lucky person. A child that never gets a nickle out of that part of the social security system is lucky.

The child who does has had some hard luck.

A mother who never gets a nickle out of aid to families with dependent children is a lucky mother.

A child who never gets foster care is a lucky child.

A person who is never disabled. Never gets a nickle. Pays into that disability fund year in and year out and never gets a nickle out of it is a lucky person.

The same for persons who are covered by health insurance, medicare. They are lucky if they never use a nickle out of it. If they have been healthy.

It is not a question of getting back what you have put in. Most social security act programs, Mr. Chairman, if you had your way in life, you would never get a penny of that money. But it is insurance against calamity which happens to x portion of the population. And, though you and I know that we will never be sick—we might be.

Senator ARMSTRONG. Is it your view that that applies to the retirement portion?

Senator MOYNIHAN. Well, the retirement portion was meant to be. We made the provision that between 65 and 72, when you are getting right to edge of life expectancy, if you haven't lost all your income, you wouldn't get all your social security. You would get 50 cents on the dollar. And after a certain point of income you wouldn't get anything.

That was the original concept of this insurance against loss of income.

Now that has changed a bit. Everybody expects some social security as part of their retirement income. But originally it was insurance, and, of course, it was insurance that would pay for loss of income when it happens to a great majority of people. Almost everybody by 65 had stopped earning. A few doctors——

Now the number of people who go on working is much larger and the situation is different because we live longer, and in fact live better, as you might think. However much those charts might alarm you, they are simply descriptive of ascending happiness and well order in the republic.

Senator ARMSTRONG. Ladies, on that cheerful note we thank you. Thank you, colleagues. Thank you for coming.

Senator MOYNIHAN. Thank you very much my colleagues and friends.

[Statements follow:]

MARY ROSE OAKAR
20th District, Ohio

DISTRICT OFFICE:
523 Federal Court Building
215 Superior Avenue
Cleveland, Ohio 44114
(216) 522-4927

WASHINGTON OFFICE:
107 Cannon House Office Building
Washington, D.C. 20515
(202) 225-5871

Congress of the United States
House of Representatives
Washington, D.C. 20515

COMMITTEES
BANKING, FINANCE
AND URBAN AFFAIRS
POST OFFICE AND CIVIL SERVICE
Chair, Subcommittee on Compensation
and Employee Benefits
SELECT COMMITTEE ON AGING
Chair, Task Force on Social
Security and Women

TESTIMONY OF
CONGRESSWOMAN MARY ROSE OAKAR
BEFORE THE
SUBCOMMITTEE ON SOCIAL SECURITY AND INCOME MAINTENANCE PROGRAMS
UNITED STATES SENATE
SOCIAL SECURITY FINANCING AND OPTIONS FOR THE FUTURE
JULY 10, 1981

I want to thank the distinguished Chairman, Senator Armstrong, for the opportunity to testify on one of the most pressing issues facing this Congress.

I speak as Chair of the Task Force on Social Security for the AGING Committee and as a Member of the Congresswoman's Caucus. One of the chief priorities of the Congresswoman's Caucus, which Congresswoman Schroeder co-chairs, is the concern over the existing and compounding inequities against women in the social security system. Furthermore, the Caucus recognizes the devastating impact the new proposals have on older women, in particular. Hearings held last month on this subject by our Aging Committee's Task Force on Social Security focused on these inequities.

The benefits paid to the American people are not only their earned right, but their legal right. No wonder there is so much outrage by our elderly and disabled people.

My remarks will address the recently released 1981 Trustees Report, refinancing proposals, and the current status of women under the program. In brief, it is my belief that the dire and pessimistic projections appearing in the Trustee's Report are flawed. They additionally have

THE POTENTIAL OF FORCING THE CONGRESS TO ACT PREMATURELY IN CONSIDERING ISSUES OF REFINANCING. I WOULD ALSO LIKE TO REQUEST THAT THE COMMITTEE CAREFULLY AND FULLY SCRUTINIZE ALL REFINANCING PROPOSALS FOR THEIR IMPACT ON OLDER WOMEN -- THE FASTEST GROWING POVERTY GROUP IN THE NATION.

THE TRUSTEE'S REPORT

THE TRUSTEES'S REPORT, RELEASED JULY 6TH, PROJECTED THE SHORT-TERM AND LONG-TERM BALANCE IN THE INDIVIDUAL AND AGGREGATE TRUST FUNDS USING THE ADMINISTRATION'S OPTIMISTIC AND WORST CASE FORECAST IN ADDITION TO THE TRADITIONAL ECONOMIC ASSUMPTIONS. TRADITIONALLY, THIS HAS BEEN A DOCUMENT THAT USED THREE ECONOMIC PROJECTIONS. THIS REPORT USES FIVE. IN ADDITION, ALTHOUGH THE TRUSTEES ARE MEMBERS OF THE PRESIDENT'S ADMINISTRATION, THE DOCUMENT HAS NEVER BEEN USED POLITICALLY TO ENDORSE A PRESIDENT'S LEGISLATIVE PROPOSALS. ALSO CURIOUS IS THE TIMING OF THIS REPORT WHICH WAS DUE IN APRIL, BUT CAME OUT AFTER GRAMM-LATTA (WHICH HAD DRAMATIC CUTBACKS IN SOCIAL SECURITY) PASSED THE HOUSE IN THE MONTH OF JULY AND BEFORE WE VOTE ON THE BUDGET CONFERENCE REPORT.

CRITIQUE OF THE TRUSTEE'S REPORT

THE MOST STARTLING FEATURE OF THE TRUSTEE'S REPORT IS ITS OVER-EMPHASIS OF THE WORST CASE SCENARIOS AND PREOCCUPATION WITH THE STATUS OF THE OLD AGE AND SURVIVORS TRUST FUND, RATHER THAN THE COMBINED TOTALS.

THE CONGRESSIONAL BUDGET OFFICE ISSUED ITS PROJECTIONS AS RECENTLY AS JUNE 16. THE C.B.O. CONCLUDED THAT (1) SUFFICIENT RESERVES WILL REMAIN IN THE OASI PROGRAM UP TO THE BEGINNING OF 1984, (2) THE DI TRUST FUND WILL IMPROVE ITS POSITION SUBSTANTIALLY THROUGH 1986, WITH RESERVES

INCREASING TO 132 PERCENT OF OUTLAYS, AND (3) THE HI TRUST FUND BALANCE WILL GROW TO OVER 80 PERCENT OF ANNUAL OUTLAYS OVER THE NEXT FIVE YEARS. OF THESE THREE TRUST FUNDS, ONLY THE OASI FUND IS EXPECTED TO EXPERIENCE A CASH FLOW PROBLEM IN THE NEXT SEVERAL YEARS. THE C.B.O. ALSO PROJECTED THE AGGREGATE TRUST FUND BALANCE AS A PERCENT OF OUTLAYS UNDER ALTERNATIVE ECONOMIC ASSUMPTIONS (BOTH ASSUMPTIONS FORECAST REAL ECONOMIC GROWTH IN EACH YEAR OVER THE COMING FIVE-YEAR PERIOD; NO FURTHER DOWNTURNS IN THE BUSINESS CYCLE ARE FORECAST). UNDER THESE ASSUMPTIONS, A SURPLUS IS PROJECTED IN THE COMBINED TRUST FUNDS UP THROUGH 1984.

THE EXTREMELY PESSIMISTIC PROJECTIONS OF THE TRUSTEE'S REPORT MUST BE CONSIDERED IN CONJUNCTION WITH THE MORE POSITIVE PROJECTIONS OF THE C.B.O. BUT EVEN IF WE ACCEPT THE TRUSTEE'S PROJECTIONS, THERE IS A REAL QUESTION ABOUT THE ACCURACY OF THEIR PROJECTIONS BASED ON THEIR OWN INTERNAL DATA.

BASED ON MY OWN INTERPRETATION OF THE DATA APPEARING IN THE TRUSTEE'S REPORT, THERE IS NO IMMEDIATE CRISIS. I WOULD LIKE TO SUBMIT FOR THE RECORD TWO TABLES PREPARED BY THE STAFF OF THE AGING COMMITTEE'S SUBCOMMITTEE ON RETIREMENT, INCOME AND EMPLOYMENT CONTAINING THESE PROJECTIONS (APPENDIX A). THE CHAIRMAN WILL NOTE THE SURPLUSES USING DIFFERENT ECONOMIC ASSUMPTIONS INCLUDING "REAGANOMICS."

I DID NOT SUPPORT THE GRAMM-LATTA PROVISIONS IN THE HOUSE, BUT BASED ON THESE PROPOSALS, TOGETHER WITH THE SENATE BUDGET PROVISIONS, WE CAN REASONABLY FORECAST THAT THERE IS NO SHORT-TERM FINANCIAL PROBLEM IN THE COMBINED SOCIAL SECURITY TRUST FUNDS. BY THE END OF 1985, UNDER THE ECONOMIC ASSUMPTIONS USED BY THE ADMINISTRATION, THE TRUST FUNDS WOULD INCREASE POSITIVELY BY $26.3 BILLION TO ABOUT $69 BILLION. EVEN UNDER THE PESSIMISTIC ASSUMPTIONS, THE TRUST FUNDS

WOULD INCREASE BY $2.7 BILLION -- NOT GO DOWN AS SOME WOULD HAVE YOU BELIEVE. FURTHERMORE, THE SITUATION OVER A 25 YEAR PERIOD IS VERY OPTIMISTIC. THE TRUSTEE'S REPORT VERIFIES THIS. DURING THIS PERIOD THE SO CALLED BABY BOOM POPULATION AFTER WORLD WAR II WILL BE PAYING IN, AND OFFSET THE NUMBER OF PEOPLE RECEIVING BENEFITS OVER 65. THE SOCIAL SECURITY SYSTEM REMAINS VERY STABLE FOR THIS 25 YEAR PERIOD.

REFINANCING PROPOSALS

I WOULD URGE THIS COMMITTEE TO AVOID ANY PROPOSALS WHICH WOULD RESULT IN A FLAT BENEFIT CUTBACK FOR SOCIAL SECURITY RECIPIENTS. THE SOCIAL SECURITY PROGRAM, CONTRARY TO ADMINISTRATION PROPOSALS, IS NOT "BANKRUPT," NOR IS IT ILL-CONCEIVED. IT HAS EVOLVED IN PRECISELY THE MANNER THE FOUNDERS INTENDED: TO SERVE AS AN INCOME SECURITY SYSTEM FOR OUR NATION'S RETIRED WORKERS AND THEIR FAMILIES, AND THE FAMILIES OF DECEASED AND DISABLED WORKERS. IN REALITY, THE PROBLEM IS NOT THAT THE PROGRAM HAS BECOME TOO EXPANSIVE, BUT THAT THE PROGRAM IS BARELY ABLE TO KEEP RETIRED WORKERS AND THEIR FAMILIES WITH A HISTORY OF LONG-TERM AND LOW-PAID WORK IN THE LABOR FORCE ABOVE THE POVERTY LINE. WE MUST NOT SACRIFICE THEIR VERY REAL AND DIRE NEEDS TO VISIONARY ECONOMICS. OUR GOAL SHOULD BE TO STRENGTHEN THE PROGRAM, AND STREAMLINE IT AS NECESSARY, WITHOUT SACRIFICING THE SECURITY OF THOSE WHO DEPEND ON SOCIAL SECURITY FOR THEIR VERY SUBSISTENCE.

LET ME COMMENT ON TWO SPECIFIC AREAS -- THE NEED FOR INTER-FUND BORROWING AND THE NEED TO SEPARATE SOCIAL SECURITY FROM THE UNIFIED BUDGET.

INTER-FUND BORROWING

I BELIEVE THE FIRST ISSUE TO BE ADDRESSED IS THE PROJECTED SHORT-TERM DEFICIT IN OASI. WE SHOULD NOT AT THIS TIME ACT ON ANY LONG- TERM PROPOSALS THAT INVOLVE DRASTIC PROGRAM CHANGES. EVEN UNDER PESSIMISTIC PROJECTIONS, INTER-FUND BORROWING BETWEEN THE OLD-AGE, DISABILITY

AND HOSPITAL INSURANCE FUNDS WOULD SOLVE MOST OF THE SHORT-TERM PROBLEMS AND ADDITIONALLY HAS THE POTENTIAL OF SOLVING LONG-TERM PROBLEMS AS WELL.

CURRENT CONGRESSIONAL PROPOSALS WOULD GIVE AUTHORITY TO THE FUNDS TO MAKE LOANS TO ONE ANOTHER WHENEVER ONE OF THE FUNDS FALLS BELOW 25% OF THE AMOUNT OF ITS DISBURSEMENTS FOR THE 12 MONTHS PRECEDING THE BORROWING.

INTER-FUND BORROWING HAS BEEN SUPPORTED BY A VARIETY OF SOCIAL SECURITY EXPERTS. THE 1980 SOCIAL SECURITY ADMINISTRATION REPORT RECOMMENDED INTER-FUND BORROWING "ON THE CONDITION THAT SUCH LOANS WILL NOT JEOPARDIZE THE CASH POSITION OF ANY ONE FUND". THE REPORT ADDED THAT THIS ACTION WOULD BE SUFFICIENT TO SUPPORT SOCIAL SECURITY THROUGH THE 1980'S. STANFORD ROSS, WILLIAM DRIVER AND ROBERT BALL, THREE FORMER SOCIAL SECURITY COMMISSIONERS WHO TESTIFIED BEFORE THE TASK FORCE, HAVE ENDORSED THE INTER-FUND BORROWING PROPOSAL.

INTER-FUND BORROWING IS A SIMPLE, COSTLESS SOLUTION TO THE CURRENT DEFICIT IN THE OASI FUND. IT WILL SEE THE FUND THROUGH THE LEAN YEARS AHEAD WITHOUT SUBJECTING OUR ELDERLY TO FURTHER SEVERE BENEFIT REDUCTIONS.

UNIFIED BUDGET

WE SHOULD ALSO ACT TO REMOVE THE TRUST FUNDS FROM THE UNIFIED BUDGET. KEEPING THE TRUST FUNDS UNDER THE UNIFIED BUDGET PERPETUATES THE DANGEROUS ILLUSION AMONG THE PEOPLE THAT SOCIAL SECURITY EXPENDITURES ARE PART AND PARCEL OF OTHER FEDERAL EXPENDITURES BASED ON GENERAL REVENUE TAXES. THE DANGERS PRESENTED BY INCLUDING THE TRUST FUNDS IN THE UNIFIED BUDGET SHOULD BE OBVIOUS. IT EXPOSES THE SOCIAL SECURITY PROGRAM TO BLATANT MANIPULATION BY PERSONS WHO WOULD USE THE FUNDS FOR A "QUICK FIX" TO BALANCE THE FEDERAL BUDGET. IT DOES NOTHING LESS THAN BALANCE THE BUDGET ON THE BACKS OF THE ELDERLY. SOCIAL SECURITY WAS NOT ORIGINALLY

INTENDED TO BE PART OF THE UNIFIED BUDGET. IT WAS INCLUDED FOR THE FIRST TIME IN 1969 TO PROVIDE AN OVERALL FISCAL PICTURE OF GOVERNMENT REVENUES AND DEMANDS FOR CREDIT. ROBERT BALL, DIRECTOR OF THE SOCIAL SECURITY ADMINISTRATION UNDER PRESIDENTS KENNEDY, JOHNSON AND NIXON, SAID THIS DECISION WAS "PROBABLY THE GREATEST MISTAKE MADE IN THE DEVELOPMENT OF SOCIAL SECURITY."

THE FINANCING OF SOCIAL SECURITY MUST BE CONSIDERED SEPARATELY FROM THE ENTIRE BUDGET. SOCIAL SECURITY POLICIES ARE SPREAD OVER LONG PERIODS OF TIME, AND ITS FINANCING DEPENDS ON DIRECT-LINE CONTRIBUTIONS AND PAYMENTS. THIS TINKERING COULD NOT TAKE PLACE IF SOCIAL SECURITY WAS RETURNED TO ITS ORIGINAL PLACE APART FROM THE FEDERAL BUDGET. REMOVING THE TRUST FUNDS FROM THE UNIFIED BUDGET SHOULD, ONCE AND FOR ALL, DISTINGUISH SOCIAL SECURITY FINANCING FROM BUDGET BALANCING ISSUES.

IMPACT OF PROPOSALS ON WOMEN

AS CHAIR OF THE HOUSE AGING COMMITTEE'S TASK FORCE ON SOCIAL SECURITY AND WOMEN, I CAN REPORT TO YOU THAT VIRTUALLY MOST OF THE PROPOSED BENEFIT CUTBACKS PUT FORTH BY THE ADMINISTRATION WILL FALL MOST HEAVILY ON WOMEN. I STRONGLY URGE THAT YOU PAY ESPECIALLY CLOSE ATTENTION TO THE IMPACT OF ANY REFINANCING PROPOSALS ON WOMEN. 72% OF ALL ELDERLY POOR ARE WOMEN. THIS PHENOMENON HAS RESULTED IN THE FEMINIZATION OF POVERTY.

WOMEN OUTNUMBER MEN AMONG THE ELDERLY. WOMEN ARE ALSO THE FASTEST GROWING POVERTY GROUP IN THE NATION.

** WOMEN COMPRISE ALMOST 60% OF ALL PERSONS OVER THE AGE OF 65, AND WOMEN OUTNUMBER MEN BY 2 TO 1 IN THE OVER 74 AGE GROUP

** THE AVERAGE ANNUAL SOCIAL SECURITY INCOME FOR WOMEN AGED 65 AND OLDER IS LESS THAN $3,800, OR APPROXIMATELY $250 A MONTH

** ABOUT 60% OF ALL WOMEN BENEFICIARIES DEPEND ON SOCIAL SECURITY AS THEIR SOLE SOURCE OF INCOME

- ** 70% OF ALL ELDERLY POOR ARE WOMEN; WOMEN COMPRISE 72% OF ALL SSI RECIPIENTS, THE INCOME MAINTENANCE PROGRAM FOR THE NEEDY AGED, BLIND, AND DISABLED
- ** BECAUSE WOMEN ON AVERAGE LIVE LONGER THAN MEN, THEY ARE MUCH MORE LIKELY TO LIVE OUT THEIR CLOSING YEARS ALONE.

ONE HALF OF ALL WOMEN, COMPARED TO ONE-FIFTH OF ALL MEN IN THE OVER 74 AGE GROUP LIVED ALONE IN 1978.

IN SHORT, OLDER WOMEN TEND TO BE POORER THAN MEN, HAVE FEWER FINANCIAL RESOURCES WITH WHICH TO SUPPORT THEMSELVES IN LATER LIFE, ARE LIKELY TO LIVE OUT THEIR LAST YEARS ALONE, AND DEPEND ON THEIR SOCIAL SECURITY AS THEIR MAIN SOURCE OF INCOME.

THE EXTRAORDINARILY HIGH INCIDENCE OF POVERTY AMONG AGED WOMEN STEMS AT LEAST IN PART FROM THEIR VARIABLE SOCIAL AND WORK ROLES WHICH ARE NOT EASILY ACCOMMODATED UNDER THE PRESENT SOCIAL SECURITY SYSTEM. IN OTHER WORDS, WOMEN ARE PENALIZED -- AND VICTIMIZED -- UNDER SOCIAL SECURITY BECAUSE OF THE CONFLICTING ROLES OUR SOCIETY ASCRIBES TO THEM. CONTRARY TO THE ARGUMENTS OF SOME, THESE PROBLEMS WILL NOT DISAPPEAR IN COMING YEARS AS MORE WOMEN JOIN THE WORKFORCE. RATHER, THEY MUST BE ADDRESSED LEGISLATIVELY. I AM ENCLOSING WITH THIS TESTIMONY, FOR THE RECORD, SUMMARIES OF SIX BILLS I HAVE INTRODUCED IN THE HOUSE DESIGNED TO RESOLVE ISSUES OF EQUITY AND ADEQUACY. (APPENDIX B)

LET ME BRIEFLY REVIEW THE PROBLEMS WOMEN FACE UNDER THE PROGRAM: IF MARRIED WOMEN WORK IN THE HOME THEY WILL HAVE LIMITED AND IN SOME CASES TOTALLY INADEQUATE PROTECTION UNDER SOCIAL SECURITY. HOMEMAKERS HAVE NO DISABILITY PROTECTION AT ALL, EVEN THOUGH THEIR WORK HAS TREMENDOUS

ECONOMIC AND SOCIAL VALUE. AS PAID WORKERS, WOMEN ARE LIKELY TO BE EMPLOYED IN LOW-PAYING JOBS WITH LITTLE HOPE OF ADVANCEMENT. THEIR SOCIAL SECURITY BENEFITS, BASED ON PAST EARNINGS, WILL LIKEWISE BE INTOLERABLY LOW. WOMEN WHO COMBINE HOMEMAKING AND PAID WORK ROLES EXPERIENCE GAPS IN SOCIAL SECURITY COVERAGE --THEY MAY LACK DISABILITY COVERAGE IN SPITE OF THEIR YEARS OF WORK IN THE LABOR FORCE; THEIR SPOUSAL BENEFITS WILL NOT REFLECT THEIR YEARS OF WORK AND CONTRIBUTION TO SOCIAL SECURITY; AND, THEIR EARNINGS RECORDS WILL BE NEGATIVELY AFFECTED BY THE YEARS OF ZERO EARNINGS. SOCIAL SECURITY OFFERS LITTLE PROTECTION, AND IN SOME CASES ABSOLUTELY NO PROTECTION, TO DIVORCED SPOUSES WITH A LIMITED HISTORY OF WORK IN THE LABOR FORCE. FINALLY, THE PROGRAM FAVORS ONE-EARNER COUPLES OF LIFETIME MARRIAGES IN A PERIOD OF OUR HISTORY WHEN THE DIVORCE RATE IS CLIMBING AND THE TWO-EARNER COUPLE IS THE PREDOMINANT FAMILY FORM.

I WOULD LIKE TO LIST, BY WAY OF ILLUSTRATION, THE WAYS IN WHICH WOMEN WILL BE AFFECTED BY CURRENT REFORM PROPOSALS:

1. THE GRAMM-LATTA ELIMINATION OF THE MINIMUM BENEFIT WILL FALL MOST HEAVILY ON WOMEN. BENEFITS WILL BE CUT BY APPROXIMATELY 40 PERCENT, AND 85 PERCENT OF THOSE AFFECTED WILL BE WOMEN. TWO-THIRDS OF THESE RECIPIENTS ARE BETWEEN THE AGES OF 70 AND 90 YEARS. ONLY 12 PERCENT HAVE ANOTHER PENSION. THESE ARE THE INDIVIDUALS THAT CAN LEAST AFFORD BENEFIT REDUCTIONS AND WILL BE MOST HEAVILY BURDENED.

2. THE GRAMM-LATTA ELIMINATION OF POST-SECONDARY STUDENT BENEFITS: LAST YEAR 32 PERCENT OF ALL BENEFITS WENT TO FAMILIES WITH INCOMES UNDER $5,000, AND MOST OF THESE FAMILIES WERE HEADED BY RECENTLY WIDOWED MOTHERS. UNDER THIS PROPOSAL THE WIDOWED MOTHER WILL LOSE A MAIN SOURCE OF INCOME.

3. The Administration proposal to reduce benefits for future and early retirees and their spouses will lower the already inadequate benefit for widows. Widows are among the poorest of the elderly, and most rely on Social Security benefits as a major source of income. The burden of this proposal will fall most heavily on single older women, the group least able to bear it.

4. The Administration proposal to reduce benefits through the addition of three more years of the retirement computation period will adversely affect women who combine homemaking and paid work roles.

5. The Administration proposal to increase the number of years needed to qualify for disability benefits and the use of medical standards only for determing eligibility will potentially disqualify more than 15 million women now eligible for disability benefits. Women, it must also be noted, are already penalized under current law if they spend more than five years out of the paid labor force rearing children.

In sum, any proposal to refinance Social Security which entails benefit cutbacks almost certainly will disproportionately affect women. It is they who can least afford any reduction at all in their retirement income, and it is our collective responsibility to insure that this vulnerable group is protected. In addition, there is no need for Social Security cutbacks if we solve our short-term problem by Inter-fund Borrowing. Proper assumptions must be used, not worse case scenarios used to induce blind panic about our Social Security Insurance program which has been viable since 1935. I urge the Committee to use objective statistics and to seek varieties of points of views when evaluating the Social Security System.

APPENDIX (A)

CHART 1

SOCIAL SECURITY TRUST FUND OPERATION FOR 1982-1985 UNDER CURRENT LAW[1/]

(all figures are net surplus (shortfall) in billions)

ECONOMIC ALTERNATIVES FROM OPTIMISTIC TO WORST CASE	OASDI	HI	OASDHI	CASH FLOW PROBLEMS (Less than 10% reserves)	FUNDS EXHAUSTED
I	(3.9)	28.8	24.9	Funds sufficient	Funds sufficient
IIA	(19.8)	21.1	1.3	Funds sufficient	Funds sufficient
IIB	(41.3)	19.0	(22.3)	1985	1986
III	(71.0)	11.4	(59.6)	1984	1985
Worst Case	(93.9)	2/	2/	1983	1984

1/ The combined OASDHI Trust Fund balance is projected to be about $42 billion at the end of CY 1981. To find the total Trust Fund balance/deficit, $42 billion should be added to the above surpluses and (shortfalls). Forty two billion dollars in combined assets will continue to be a more than adequate cushion for the 1982-1985 period since it represents about 21 percent of the projected $200 billion in combined benefit payments exacted in CY 82 and almost 14 percent of the projected $310 billion in combined benefit payments in CY 85 under the pessimistic (Alternative III) assumptions.

2/ The Trustees provided no "worst case" figures given for HI. Subcommittee staff estimates there would be a HI net gain of about $8.9 billion under the worst case scenario leaving a combined OASDHI shortfall of about $85 billion.

Source: Staff calculations based on 1981 Annual OASDI Trustees Report, Table 14, page 40 and 1981 Annual HI Trustees Report, Table 10, page 38.

Prepared by the Subcommittee on Retirement Income and Employment of the House Select Committee on Aging. (phone 225-4045

CHART 2

COMBINED OASDHI TRUST FUND OPERATIONS FOR 1982-1985 UNDER VARIOUS CURRENT LEGISLATIVE PROPOSALS[1]

(all figures are net surplus (shortfall) in billions)

ECONOMIC ALTERNATIVES FROM OPTIMISTIC TO WORST CASE	CURRENT LAW	GRAMM-LATTA II/SENATE BUDGET[2]	ADMINISTRATION[3]
I	24.9	49.9	81.9
IIA	1.3	26.3	58.3
IIB	(22.3)	2.7	44.7
III	(59.6)	(34.6)	17.4
Worst Case	(85.0)[4]	(60.0)	(8.0)

[1] The combined OASDHI Trust Funds balance is projected to be approximately $42 billion at the end of CY 1981. This figure should be added to the above surplus or (shortfalls) to find total trust fund balance.

[2] Reliable but unofficial estimates put the savings of both the Senate and House budget bills at about $25 billion over the next four years. The enactment of these proposals would solve the short run financing problems entirely under Alternatives I, IIA and IIB. Under the two pessimistic alternatives, cash flow problems would develop in 1985. Funds would become completely depleted in 1986 under worse case and later under III.

[3] According to page 7 of the May 12 HHS Fact Sheet, the Administration's proposals result in 1982-1985 savings of $57.1 under Reaganomics and $77.3 under worst case. The above figures assume savings of $57 billion under Alternatives I and IIA; $67 billion under IIB; and, $77 billion under III and worst case. The Administration's proposals more than solve the cash flow problems under all the economic scenarios.

---

[4] Subcommittee staff estimate. See footnote 2 of Chart 1.

Prepared by the Subcommittee on Retirement Income and Employment of the House Select Committee on Aging. (phone 225-4045)

CHART 3

SOCIAL SECURITY LONG RANGE TAX RATE SURPLUS/SHORTFALL UNDER CURRENT LAW[1/]

ECONOMIC ASSUMPTIONS	OASDI 1981-2005	HI 1981-2005	OASDHI 1981-2005	OASDI 1981-2030
I	1.95	(0.42)	2/	1.64
IIA	1.27	(1.18)	0.17	0.30
IIB	0.43	(1.44)	(0.92)	(0.52)
III	(0.61)	(2.80)	2/	(2.85)

1/ The current OASDHI tax rate is 6.65 percent each on employers and employees. Under current law it will rise in increments until it reaches 7.65 percent in 1990. A tax rate surplus is the amount by which the currently scheduled tax rate exceeds the amount needed to exactly cover expected benefits. A tax rate shortfall is the amount by which the currently scheduled tax rate falls below the amount needed to exactly cover expected benefits

2/ Due to the volatility of long range estimates, the HI Trustees limited their estimates to 25 years. The OASDI trustees continued to make estimates for 75 years. The trustees made combined OASDHI estimates only for 25 years and only under the intermediate assumptions. Staff calculates that there would be a 1.56 surplus under alternative I and a 3.23 shortfall under Alternative III.

Source: Subcommittee staff calculations based on the Summary of the 1981 Annual Trustees Reports, Table 4, page 17, and Table 5, page 18; the OASDI Trustees Report Tables 26 on page 59 and G-2 on page 116; and, the HI Trustees Report, Table 11, page 39.

Prepared by: Subcommittee on Retirement Income and Employment of the House Select Committee on Aging. (phone 225-404

APPENDIX B

Summary of Social Security Bills Introduced by
Mary Rose Oakar (D-Ohio)

SOCIAL SECURITY MODERNIZATION ACT H.R. 1513

(Mandatory Earnings Sharing) The combined earnings of a husband and wife during their marriage shall be divided equally between them for purposes of determining eligibility for, and the amount of, old age and disability benefits. The bill maintains the current treatment of, among others, children's benefits, requiring that all earnings be credited to the wage earner for the purpose of calculating those benefits. The bill contains a present-law guarantee that, if the combined benefits of an individual and his or her spouse would be greater without application of earnings sharing, it shall not apply. The bill also mandates periodic Congressional studies of the operation of Earnings Sharing. Full-scale Earnings Sharing (excluding present-law guarantees) will be implemented by 2010, contingent upon the assessments, evaluations, and recommendations of the Congressional studies.

INHERITANCE OF EARNINGS CREDITS BY SURVIVING SPOUSE OR SURVIVING DIVORCED SPOUSE H.R. 1514

When a spouse dies, the surviving spouse or surviving divorced spouse automatically "inherits" the deceased spouse's earnings credits to the extent that the credits were earned during their marriage. The couple must have been married to each other for a continuous period of a least three years immediately prior to the spouse's death or the date the divorce became final. Disabled worker benefits could be paid at any age to disabled individuals based on their records as altered by inheritance. Disabled widow (er)s who gain disability insured status only through the use of inherited credits must meet the test of disability that is presently applied for disabled widow(er)s who claim survivor's benefits. The bill contains a present-law guarantee that, if the benefits of a widow(er) would be greater without application of credit inheritance, it shall not apply. Present-law guarantees will be terminated by 2010, contingent upon the findings and recommendations of mandated Congressional studies to determine impact. Where the deceased spouse has other survivors entitled to benefits on his or her account, for benefit purposes, the Social Security Administration will treat his or her earnings as if the inheritance had not occurred.

APPENDIX B, p. 2

CREDIT SPLITTING AT DIVORCE H.R. 1515

Credit splitting at divorce will make Earnings Sharing mandatory upon application by either party following a divorce. At the time of the divorce, if the marriage lasted at least three years, either party could apply for earnings credits. The Social Security earnings credits received in the years of marriage by both spouses would be added together and each spouse would be credited with half of the combined total. Earnings credits from years before or after the marriage would be unaffected. Thus, divorced homemakers or secondary earners could gain entitlement to benefits as retired workers. Credits gained as a result of credit-splitting could be used to gain entitlement to disability benefits. In those cases where combined benefits of both spouses would be higher under present law, credit splitting would not apply.

TRANSITION BENEFIT H.R. 1516

This bill provides for payment of a "transition benefit" to the widow(er) of an insured individual upon the wage earner's death, if the surviving spouse is at least 50 years old at the time of the wage earner's death and not otherwise immediately eligible for benefits. The benefits would be available only for the month in which the death occurred and for the next three months. The benefit would be 71.5% of the wage earner's primary insurance amount (PIA), or if the spouse's own primary insurance amount is higher, 71.5% of that amount.

DISABLED WIDOWS/WIDOWERS UNDER SIXTY H.R. 1517

Under present law disabled surviving spouses are eligible for benefits at an actuarially reduced rate beginning at age 50, based on the deceased worker's primary insurance amount (PIA). This bill would make disabled surviving spouses eligible for benefits at any age and with no reduction.

Senator ARMSTRONG. Could we ask the panelists who were interrupted and to whom we are grateful for their indulgence to return.

Senator Moynihan is approaching the charts over there. Did you want to point something out?

I'll tell you this, out our way it's not just that they expect benefits, they insist on it if they have paid into it all their lives.

Gentlemen, I do apologize. I am sure you can understand that in order to make our system work, we need to be somewhat accommodating to our colleagues who are faced with rollcall votes on the other side. It is only for that reason that we would take the unusual step of interrupting our proceedings this afternoon. I am very sorry for having done so.

Mr. Jones, we thank you for your testimony, we will be back to you in a moment.

Senator MOYNIHAN. Mr. Chairman, could we have order?

Senator ARMSTRONG. Thank you, Senator Moynihan.

We will call then upon Mr. Preston C. Bassett consulting actuary from the National Association of Manufacturers.

STATEMENT OF PRESTON C. BASSETT, CONSULTING ACTUARY, NATIONAL ASSOCIATION OF MANUFACTURERS

Mr. BASSETT. Mr. Chairman, and members of the subcommittee. My name is Preston C. Bassett. I am a consulting actuary.

I am before you today representing the National Association of Manufacturers. The NAM is an organization of nearly 12,000 members of every size and industrial classification located in every State.

Our members employ 85 percent of the workers in manufacturing employment. I might comment we represent workers too. And produce over 80 percent of the Nation's manufactured goods.

Senator MOYNIHAN. I might agree.

Mr. BASSETT. Many of our members provide some form of retirement program for their employees and nearly all are covered by social security system.

The NAM consistently supports the social security program in its role of providing a basic floor of protection. We strongly believe that the financing should continue to be self-supporting through separate taxes paid equally by employers and employees and general revenue financing should be avoided.

The NAM believes that revision in the benefit, coverage, and financing aspects of the social security system is essential in order to preserve the integrity of the program and to restore the public's confidence in it.

On indexation of benefits, NAM's foremost recommendation in the benefit area is to change the method of indexation for beneficiaries on the roll. Average wages have not risen as quickly as prices over the last two recessionary periods. During these times social security benefits have been protected by automatic increases—reflecting the rise in the CPI—which have been larger than average wage increases.

Specifically, the benefit increase should be determined from the smaller of the wage increase or the price increase rather than solely on the basis of the latter.

Changing the method of indexation would prevent retirees from gaining disproportionately to workers over these periods.

Additionally, and of greater significance today, it could generate substantial savings for the social security system.

On retirement age, the NAM also believes that Congress and the administration should give serious consideration to raising the normal retirement age from age 65 to age 68. We feel that increasing the eligibility age for receipt of full retirement benefits should be phased in beginning around the year 2000.

This is similar to the approach taken by the National Commission on Social Security.

On universal coverage. Universal coverage can solve many anomalies and inequities as some noncovered Government employees lose out because of gaps in social security coverage.

To achieve this end, the NAM recommends that HI coverage be extended to Federal employees to be effective next year and that universal coverage of OASDI-HI be extended to new Federal employees as it becomes practicable.

The extension of HI coverage to Federal employees would bring approximately $2½ billion annually in additional revenues to the social security system.

We also endorse, in principle, extending HI coverage to State and local employees, recognizing however, that there may be a question of the constitutionality.

In conclusion, the NAM in its general support of the social security program is very concerned about the mounting financial problems that threaten the operation of the system in both the short and long term.

We commend the subcommittee for taking prompt action on this crucial issue and we thank you for this opportunity to appear. We hope that our comments will be useful to the subcommittee in examining the social security financing options for the future. And our complete statement is included for the record.

I welcome your comments and we will try to answer any questions you may have.

Senator ARMSTRONG. Thank you, Mr. Bassett. We will look forward to chatting with you about that.

I would like to call on next the representative of the United States Steel Corp. and the Council of State Chambers of Commerce. And, may I inquire, do I say your name Re, as if it were spelled R-a-y?

Mr. RE. Yes, sir.

Senator ARMSTRONG. Mr. John Re.

Mr. RE. Thank you.

STATEMENT OF JOHN RE, STAFF TAX ADMINISTRATOR, UNITED STATES STEEL CORP. AND MEMBER OF COUNCIL OF STATE CHAMBERS OF COMMERCE

Mr. Chairman, members of the subcommittee, my name is John Re. I am staff tax administrator, United States Steel Corp. and chairman of the Social Security Subcommittee of the Employee Benefits and Relations Committee of the Council of State Chambers of Commerce.

I speak to you today on behalf of that committee.

Accompanying me is Mr. William R. Brown, president of the Council of Chambers of State Chambers of Commerce.

We appreciate the opportunity to appear before you today as we believe that action is needed if we are going to place social security on an unquestionably sound basis.

The system is currently experiencing financial problems for both the short and long-terms. With, in our opinion, the long-term forecast being especially onerous.

There have been proposals made in three general areas for the resolving of the financial problems of social security.

One of these is the use of general revenue financing. It is our belief that general revenue financing is not in the best interest of social security.

The social security program must contain the mechanism of self-financing by the payroll tax, whereby, the participants are informed through payroll deduction as to their involvement.

We believe that the biggest single factor in the public's acceptance and support of social security over the years is the fact that the people view social security as an earned right and not welfare.

General revenue financing would weaken this perception and should therefore be rejected.

We support interfund borrowings between the OASI, DI, and HI trust funds as we believe this can serve as a useful tool to overcome short-term problems.

The second option is to increase taxes. This subcommittee is already aware of the current scheduled increases in social security taxes over the next several years.

We also believe that you are painfully aware of the public's reaction to this year's tax increase. We feel that our current tax rates have reached the maximum acceptable levels.

Further increases are not the solution. And like general revenue financing should be rejected.

While we would support the administration's proposal for a reduction in the long-range social security taxes, we feel that there must first be a balancing between fund income and outgo.

We cannot support the taxation of the first 6 months of sick pay.

Finally, one of the more difficult options available——

Senator MOYNIHAN. I am sorry, Mr. Re, could you repeat that. The first 6 months.

Mr. RE. Yes.

Senator MOYNIHAN. I didn't hear. You do not support taxation.

Mr. RE. Yes; we cannot support the taxation of the first 6 months of sick pay. Currently sick pay is excluded from coverage. The administration's proposal is to tax the first 6 months.

Finally, one of the more difficult options available is to reduce and/or eliminate certain benefits.

We feel, however, that this is the most appropriate course of action, and strongly recommend that inappropriate benefits be eliminated and that there be moderate reductions in benefits levels to contain future costs.

Our basic policy is that OASDI should represent a minimum layer of protection. We feel that some reductions can be obtained without destroying this level of protection for most workers.

We feel that it is indeed appropriate to eliminate the unearned benefits, the student, death, and minimum benefits immediately. And would add our support to the legislation embodied in the budget reconciliation proposals cleared by the Senate and House.

We are hopeful that the Senate and House will be able to reconcile the differences that do exist and that we will be able to support the final package.

There have been a number of other proposals made by the administration and the House Ways and Means Social Security Subcommittee for reducing benefits which we generally can support. However, we suggest that certain changes be phased in over a longer period of time in order that the rules are not changed in the middle of the game. However, interim changes may be desirable.

In this regard, we would join the many who would suggest that the current indexing method used for determining the benefit formula and for escalating benefits in the taxable wage base need to be modified if the program is to return to fiscal soundness.

To accomplish these goals will take time. However, we feel that in the interim indexation should be limited to the lower of the CPI or the wage base for adjustments to the bend points, benefits, and the taxable wage base.

We feel that the administration's proposal to increase bend points by 50 percent, instead of 100 percent of wage increases for the period 1980 to 1987 is much too rapid. As a modification, we would accept increasing the benefits by 50 percent for 2 years—1982 and 1983. And an increase by the lesser of the CPI or wage increase indexes.

Another crucial aspect of the program is the determination of the retirement age. We believe that because of the fact that people on average live longer, healthier lives today, than they did when the retirement age was first calculated, the retirement age should be raised on a phased-in basis beginning in the year 2000.

Benefits for early retirees could possibly be reduced below the 80 percent for a person retiring at age 62. However, the administration's proposal of 55 percent is too great of a reduction as it does not approximate a reduction based on estimated actuarial assumptions.

Substantial retirement from active employment should be maintained as a basic condition of eligibility. With respect to universal coverage, we strongly believe that coverage under social security should be extended to all workers.

Finally, in conclusion, we have attempted through this oral testimony to outline ways which we believe could raise receipts and decrease outlays for both the short and long term. We urge this subcommittee to consider these recommendations throughout your future deliberations.

Congress must face up to both the short- and long-term issues which is necessary to keep the program fiscally sound and to avoid widespread public apprehension.

It is our belief that through the changes we suggest, an unquestionably sound financial base for the social security system will be a place for today's beneficiaries and workers.

Thank you very much.

Senator **Armstrong**. Thank you, Mr. Re.

Last, but not least, we are pleased to welcome James D. "Mike" McKevitt whose testimony, I think, will be particularly significant. Not only because he is an astute observer of the legislative process, but because, as I understand it, he represents the organization which in membership is the largest of all the business organization—an organization which has devoted a considerable amount of scholarly attention to the problem of social security.

I don't know if it is included in his testimony, but I am aware that NFIB has in fact been studying this problem for some time and has hired independent experts and authorities to do a significant amount of original research.

STATEMENT OF JAMES D. "MIKE" McKEVITT, DIRECTOR OF FEDERAL LEGISLATION, NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Mr. **McKevitt**. Thank you, Mr. Chairman, Senator Moynihan. My name is Mike McKevitt, director of Federal legislation, National Federation of Independent Business. We have now in excess of one-half million members who in turn hire over 14 million employees.

Both of you are aware that sometime ago we retained Prof. Michael Boskin from Stanford University to explore this problem with us.

The reason we did so was because about 3 years ago on our surveys of taxes that were having an impact on small business the one that popped right to the top was payroll taxes.

As a result, we got into it. And got into it in great depth.

I regret that Professor Boskin could not be here to testify today. I would like to testify briefly on some of his observations and also our recommendations on solutions which, hopefully, may have some appeal to both of you.

We feel it's a problem, it has been a serious problem for as I say the last three years. We commissioned the Terrance Poll out of Houston several months ago to do a survey throughout the country. They came up with some interesting findings reflected in the testimony that approximately two-thirds of the people in the country feel that the system is in trouble. If you get into the age cohort of 19 to 25, it jumps up to 85 percent of those who feel that it is in serious trouble and there is very great negativism as to whether anything will ever be there for them.

To us it looks more and more like a giant chain letter that has to be remedied, and remedied soon.

To me it is not fair, for example, I know a lot of people think I have paid in fair and square to the system. We find out they have really only paid in about 15 percent. So we have to look at it twofold. One as an annuity program, and one as a supplemental retirement benefit program based on need which I will touch on in a minute.

If we don't do something about it, this generational conflict is going to develop to a greater degree. And the Pepsi generation, when they retire at the turn of the century, is going to find that there is nobody behind them of great numbers to really provide continuation of financing.

It is a big problem, and an important problem for small business. Small business is not small potatoes in this field, as you both know; 56 percent of the private work force in this country is small business.

Two-thirds of the new jobs in the last decade were created by small business.

Yet, as one of our members, Mr. Michael, pointed out this morning, he is not hiring. He layed off two this last year. And he has got an employee problem on his hands with those who are concerned like the one employee, for example, who want a legitimate retirement program.

So there we have the problem, what are we going to do about it?

We say at the heart of the proposal is a separation of social security's, annuity and transfer functions. The idea is to provide social security annuities to retirees based entirely on the amounts they and their employers have contributed in payroll taxes, plus interest earned.

Benefit levels would not be affected by such things as the earnings test and number of dependents. For example, if the average person at retirement had $60,000 in his or her social security account and life expectancy was 10 years beyond retirement, that person would draw $6,000 a year—$500 a month—benefit. Annuities would continue to be financed by FICA taxes. Nothing could be simpler or more equitable.

Under the present system, why is it, for example that a person as reflected in the Washington Post in an article 1 week ago, has two homes, a boat and is probably getting 5 to 6 times back what they paid in. That is not equitable. I think that that has to be changed.

Because of the fact that there are many today who don't need the total amount of social security. And who have not earned it, with due respect, fair and square.

This does not eliminate the need for the social transfer payments for those who are poor or for other reasons need help.

The supplemental social transfer program, based on need, would provide such benefits from general revenues.

Gentlemen, I respectfully submit that we have got to get rid of this myth that we can't do it out of general revenues. Why should payroll taxes, why should part of the working force of this country—not Federal employees, not most State employees—be expected to pay for these social transfer elements of the program.

With due respect, some of my colleagues are shaking their heads in disagreement. Disagree with me. But I think we should do it.

Our plan would accomplish two major objectives. Guarantee every working American a fair return upon retirement on all the money he or she paid into the system over the years; and two, establish a fair mechanism for providing retirement benefits to those who have little or no means of subsistence other than the entitled annuity.

Under current law, social transfers are paid to virtually every retiree whether needed or not.

For the retiree with a substantial private pension the social transfer amount is just the same as for the poverty stricken retiree.

Under our plan, social transfer payments to the nonpoor are eliminated. The effect is a net cost reduction.

Further benefit equity is created. Everyone, including the young, can expect a fair return on his or her social security tax dollar.

If that return, plus other income and assets, proves insufficient, affected elderly would draw resources under a program specifically designated or designed to help them.

Finally, the program of increases in FICA taxes, particularly a severe tax for small business, could be reduced.

Finally on two things, Mr. Chairman, Senator Moynihan, taxing Federal employees is not going to solve the problem, it is going to make it worse. This is one of the things that the Boskin Survey brings out.

The final aspect is that the payroll impact—why are those working in the private sector have to cover this broad program as I mentioned earlier. I think the burden should be equitably disbursed through general revenue for those parts of the program that are truly social transfers.

Thank you.

Senator ARMSTRONG. Thank you, gentlemen.

Senator Moynihan.

Senator MOYNIHAN. We have heard a thing or two, haven't we, Mr. Chairman?

May I ask Mr. McKevitt if we could get that study—I would like to see that analysis of the Federal employee impact. It is something we hear a great range of views on, but we don't see data.

Mr. McKEVITT. I will furnish it to you and we also have requested, through Congressman Jake Pickle as well as Senator Armstrong, the respective chairmen, the request for an actuarial study of this program, and we hope to have the results of that this coming week. We will be glad to furnish that. We have not submitted a plan for introduction or sponsorship at this point until we have the actuarial results back from the Social Security Administration. Congressman Pickle, Congressman Archer, and Senator Armstrong have been gracious enough to request this for us, and so we will have that too.

Senator MOYNIHAN. I would like to make two more comments thanking for clear precise testimony.

Mr. Re, could I interpret your testimony as a suggestion that you would not be supportive of the proposal to eliminate any earnings test?

Mr. RE. We are opposed to the elimination of the earnings test.

Senator MOYNIHAN. Don't tell that to me. Tell it to the Chairman, would you?

Mr. RE. We are opposed to the elimination of the earnings test.

Senator MOYNIHAN. You are from the Communication Workers of America?

Mr. RE. United States Steel.

Senator MOYNIHAN. The United Steel Workers?

Mr. RE. Not U.S. Steel Workers, United States Steel Corp.

We feel that the provision in the current law should stay there.

Senator MOYNIHAN. There is an element of insurance against loss of income in the program.

A case could be made for eliminating the test, but not in the context of the cuts that are being proposed. We have to use the money the way we best can.

I take it, sir, that you would share my sense of the near term problem. If the United States Steel Corp.—as a typical established company—had the sort of situation that little chart of mine over there depicts, that of pension payments declining as a portion of your payroll over the next 35 years, then rise, you would not be in such bad shape. You have a near-term problem in 5 years that might come to, golly, $10 billion of $2 trillion. My arithmetic is not good enough. That's not a large percentage. You would get through the near term by borrowing in one form or another. You look to a pretty solid 30-year prospect.

Mr. RE. We would, of course, be concerned with a long-term aspect.

Senator MOYNIHAN. Then you would look at that long-term draft, and you would say somebody better pull his socks up.

Mr. RE. The fact is our pension plan is negotiated with the USW, U.S. Steel Workers of America. I am sure of the continuance of the pension payments because the pension payment is out of the trust, it is not out of the earnings of the company. It's out of a trust.

Senator MOYNIHAN. Right.

Mr. RE. If we were to shortfall there, there would certainly have to be some kind of negotiation for the short term.

Senator MOYNIHAN. Those appearing have not in any sense denied that there is a problem which will come in the next century, owing to the kind of funny demography of baby boom preceded by dearth, then followed dearth. We are going to have an early 21st-century problem.

I didn't hear any of you say that the next 5 years——

Mr. Romig. Senator, I would like to go on the record here. I am Mike Romig of U.S. Chamber. I am a specialist in retirement for the business community and I would have to say in my discussions with the business community and others that we do believe this program is in trouble. I shy away from the word crisis because it is——

Senator Armstrong. What do you mean when you say "crisis"? Will you tell us what a crisis is? And I invite Senator Moynihan to tell us too. He has used that word a lot. I wonder what does that word mean?

Senator Moynihan. I have called attention to the use of the word, Mr. Chairman.

Senator Armstrong. When you call attention to it, what does the word crisis mean?

Senator Moynihan. Ask the trustees. They said in their two-page summary of their report, they used the word crisis four times and bankrupt once.

Mr. Romig. Senator, let me just shed this——

Senator Armstrong. Would you excuse me just a moment.

I am going to put into the record what the word "crisis" means.

Repeatedly Senator Moynihan has objected to a press release, which I never saw until an hour ago, in which the term "crisis" was used. And he is correct—on one, two, three, four occasions the word "crisis" is used to describe the condition of the social security system.

I would just direct the Senator's attention and the witness' attention—he has been asked whether or not there is a crisis, what the term means.

It means, and I am now quoting from Webster, "the turning point in the course of a disease, when it becomes clear whether the patient will recover or die."

Second, and I think a more applicable definition: "A turning point in the course of anything; a decisive or crucial time, stage or event."

In the judgment of the Senator from Colorado—and I don't mean to guide the witness—we are at that kind of a time. We are at a time of decision, a time when we will determine whether or not in the future things will be better or things will be worse.

I believe, Senator, it was a proper use of the word.

Excuse me for interrupting the witness.

Mr. Romig. I was just going to say that we would prefer the use of the word critical. It is critical that we examine the program that this committee is doing.

We are——

Senator Armstrong. A bit later I am going to bring up the word bankruptcy, which is also mentioned.

Mr. Romig. We are at a critical stage for the social security program. It is troubling to the business community. We are troubled about the prospect that the program will not be there. Many employers do rely primarily on social security for meeting the retirement needs of their employees.

Many others factor that program into their retirement programs. And it is critical to the future retirement planning of these companies. They are concerned about the payroll taxes, quite clearly. That was the message earlier today from the small businessman. We don't want that payroll tax to rise because it is a highly inflationary tax.

And, we do agree with the thrust of the administration's proposals. Namely, that we have got to scale back the promises that we have made because we have determined that we cannot afford those promises. It is going to be a much more difficult burden as one of the charts shows up there because there will be less people to pay the tax than there is now.

Senator Armstrong has pointed out there is reason to wonder if future taxpayers are going to be willing to make those payments.

And, moreover, we approach the social security program the same way we approach our private pension programs. A feeling that we have a fiduciary obligation to play it safe.

We owe it to these people to play it safe. It would be derelict to go ahead and assume that the best of all times will occur when there is a prospect, I won't say how much of a prospect, because I don't know; but there is a prospect that the worst of times may be ahead of us.

We owe an obligation to our employees.

Senator MOYNIHAN. You needn't remind a Democrat. [Laughter.] I would like to say to Mr. McKevitt that you obviously, clearly, would like to separate out the transfer payments even though they could be argued to be insurance. You would favor, for example, use of general revenue funding for medicare?

Mr. MCKEVITT. We are getting mainly into the retirement itself right now. We have not addressed ourself to medicare as of yet, Senator.

Senator MOYNIHAN. Well that is known as an aspect of insurance.

Mr. MCKEVITT. Right.

Senator MOYNIHAN. It is also an aspect of pension. Doctor bills under medicare are paid from general revenues.

Mr. MCKEVITT. Right.

Senator MOYNIHAN. You had a question, Mr. Re?

Mr. RE. I wanted to say something about this, you know, long-term deficit, Senator. It is really nothing new. I have in front of me the background data for the Committee on Finance of the U.S. Senate when Senator Long was chairman. This was issued in February 1980, and it shows under the intermediate assumptions which would be the intermediate two, as they call it today, a long-term deficit of 1.20.

Senator ARMSTRONG. 1.20 what?

Mr. RE. Percent of taxable payroll, sir.

Senator ARMSTRONG. What is that in dollars?

Mr. RE. In dollars, I don't know, but I know that in——

Senator MOYNIHAN. About $1.5 trillion.

Mr. RE. In the 1981 trustees report, that deficit is 1.82 percent, which is $1½ trillion.

Now if the 1.82 is $1½ trillion and my pen went dry here writing out the zeros. Even if it is 50 percent wrong, it is 700—well, if it is

100 percent correct, it is $1.5 trillion. If it's half wrong, it is $750 billion, and even if it is 75 percent wrong, it is still $375 billion—which is a lot of money.

So we certainly have to address the problem. I don't think we can say it is all politics. But the numbers are being generated with the Reagan administration. This is something that's been going on for some time.

Senator **Moynihan**. The President's proposal would cover about 3 percent of the payroll in the context of about 1½ percent of payroll deficit.

No, there is no question about that.

But may I make a point that in all truth, and I don't expect anybody to agree with me—the social insurance system run by a government is different from one run by——

Mr. **Re**. Sure, no question about it.

Senator **Armstrong**. You can bet on that because if any of these companies operated these pension funds the way we are operating the social security system, they would all be in jail. There is no question, it's a different deal. There is no doubt about that.

Mr. **Re**. Because of the ERISA requirement.

Senator **Armstrong**. We operate under different laws.

Senator **Moynihan**. May I also make a point about the idea that there is going to be some awful trouble out there.

The dependency ratios, which the demographer uses to speak in terms of the ratio of persons 20 to 64 as to other persons, will decrease. Does the ratio go down for the next 40 years, Mr. Romig?

Mr. **Romig**. Although the ratio of children decreases the aged ratio increase. The social security program is designed to take care of the aged.

Senator **Moynihan**. I am just saying—I make the point that the ratio of number of dependent persons we are asked to care for—the 20- to 64-year-old population—goes down.

Mr. **Bassett**. I think Senator Armstrong answered that very well this morning.

Senator **Moynihan**. Well, I don't know, I guess I don't——

Senator **Armstrong**. Would you say that a little louder please. [Laughter.]

Senator **Moynihan**. I think he answered it very well with respect to those first years of life. That is the time when all you need to take care of your baby is one pillow and one dresser drawer. Remember that? Then they get to be teenagers, they go to college.

I'd rather take care of five grandparents than five undergraduates. At least that's my experience.

But, no matter, you answered it very well.

Senator **Armstrong**. Gentlemen, I have a couple of questions that I would like to ask for the record.

First of all for Mr. McKevitt: One of your members this morning testified—I thought in pretty vivid terms—about the sense of bitterness that, at least in his concern, employees in Pennsylvania felt. They just felt that they were being taxed beyond what was fair.

I would like to ask if there is anything in your general experience in talking to NFIB members, or in the survey data that you cited, that would tell us whether or not that is a general problem, or is it an isolated concern?

The reason I raise that question is that I agree wholeheartedly with the testimony of Mr. Twomey earlier, in which he observed that the ultimate soundness of the system hinges on the continued willingness of each succeeding generation to participate in the system.

I believe it was Mr. Michael who testified that the people up his way are just not so sure that they want to participate in this anymore. Do you have any data on that?

Mr. McKevitt. Yes, we do, Senator.

Mr. Michael is a classic example of what is happening to small business all over the country.

As you know, we poll our members every 6 weeks on business issues. And, they send reply cards into Members of Congress and they also have a separate comment section that comes into NFIB. And, every time, for the last couple of years, edition after edition, there is all these comments in there about payroll taxes and about social security; and they are saying it is not going to be there. My employees are concerned about it. And you talk to the youth of this country—especially that younger. You talk to people in the 40's are concerned about it.

The Terrance Poll brings it out. It is a legitimate poll. And it has been a major problem not just in the past—it isn't just the Commission's report, I think it has been a problem for several years. That is why we have been into this for 3 years running now and we see it all over.

We see a tremendous problem where like Mr. Michael, hundreds if not millions like him can say, "Look, I can't provide the health care I would like to provide for my employees. I can't provide for the additional retirement plan for my employees because the payroll taxes are killing me."

And in due respect to the gentlemen who have now left the panel and say everything is good and they can sleep at night, when was it last where small business paid 21 to 24 percent interest like they are doing right now.

Our members are dropping like flies every day of the week, Senator.

Senator Armstrong. Thank you, Mr. McKevitt.

A comment on that point from other panelists?

Mr. Romig. The sentiment is universal, Senator. It is just not small business. We hear from large businesses that payroll taxes have been escalating. Our own surveys show that this cost is the fastest growing cost of the fringe package—if you want to call it a fringe package. To repeat, statutorily mandated payroll costs are the fastest growing element of the pay package.

Senator Armstrong. One of the issues we really haven't talked about much during these hearings is the fact that, as I understand it at least, the administration proposal calls for an actual reduction in payroll taxes.

What we are seeing projected in various ways over here is a sharp increase in payroll taxes.

Aside from how people feel about it—has any research been done on what macroeconomic effect on the economy is of these rising payroll taxes?

Mr. **Romig**. Senator, I have asked our economic analysis policy unit to prepare just such an analysis. And we were waiting for the trustees' report to use the varied assumptions that the trustees would have. We will probably produce one for four of the five scenarios and the fifth one will be a short-term scenario. We will provide it to the committee.

Senator **Armstrong**. That would be very helpful.

Mr. **Romig**. The variety of——

Senator **Armstrong**. What's the timetable on that? When would we have that?

Mr. **Romig**. We could probably generate that within 10 days.

Senator **Armstrong**. That would be great, we would be very happy to have that.

[Material follows:]

SPECIAL REPORT
ECONOMIC IMPACT OF INCREASES IN SOCIAL SECURITY TAX RATES

U.S.
Chamber
Forecast
Center

Dr. Richard W. Rahn, Vice President and Chief Economist
Dr. Paul A. Reardon, Associate Chief Economist
Mr. Ronald H. Clarke, Director, Forecast Center
Ms. Graciela Testa Ortiz, Associate Director, Forecast Center

Chamber of Commerce of the United States
1615 H Street, NW Washington, DC 20062

October, 1981

EXECUTIVE SUMMARY

In response to the financial crisis facing the Social Security system, Michael J. Romig of the U.S. Chamber recently discussed with Senator Armstrong a proposal to increase payroll tax rates. Their discussion focused on the economic impact such a fiscal policy change would have on the economy. Subsequently, the Forecast Center was asked to provide an economic assessment of the proposal. This report presents the economic impact of bringing forward the scheduled 1985 tax rate increase to 1982 (Alternative I) and to 1983 (Alternative II).

Although the tax rate increase would provide some relief in the form of higher revenues, this relief can be expected to be only temporary. Resultant slower economic activity will aggravate the system's financial burden. Both unemployment and inflation will be higher. Therefore, benefit payments (which are indexed to inflation) can be expected to be higher while receipts will tend to be lower. The experience subsequent to the 1977 Amendment to raise payroll tax rates lends support to this result. In the years following the legislation economic performance has been poor. Consequently, the gap between social security revenues and outlays widened. The fact is that tax rate increases impair incentives with the end result being slower economic growth.

The economic impact of the tax proposal is assessed by comparing the path of the economy in a baseline or reference case with that in the two Alternative scenarios. The baseline forecast assumes the policy changes contained in the Reagan Economic Recovery program including the 'current law' increases in the payroll tax rates. The Alternative forecasts were generated by imposing on the baseline forecast the payroll tax rate increases in 1982 and in 1983.

The increase in the payroll tax rates from 6.70 percent to 7.05 percent represents an increase in cost to both employers and employees. The higher cost to employers is an impediment to business spending on both labor and capital inputs. Faced with the higher tax rate per employee hired, it discourages labor employment. Also, the increase in business costs reduces the available funds for business expansion. As a result the growth in investment is slower with the tax rate increase than without it. The analysis shows that by 1985, business spending is forecast to be about $2.2 billion lower in both Alternative forecasts than in the baseline case.

The higher cost to employees provokes the leisure-work trade off because it is now relatively cheaper to engage in non work activity than it is to work. More importantly, it encourages early retirement in the face of lower after tax incomes relative to generous Social Security benefits. The payroll tax increase is expected to result in a 1985 job loss of about 300,000 and a 0.1 percent increase in the unemployment rate.

The slowdown in capital and labor investment with the tax increase is translated into slower output per man hour. By 1985, productivity growth is forecast to be 0.1 percent slower than it would have been without the payroll tax rate increase. This puts upward pressure on unit labor costs which in turn puts upward pressure on consumer prices.

Accordingly, overall economic performance is made worse off by the increase in payroll tax rates. By comparison, the growth in total output -- adjusted for inflation -- is forecast to be slower by 0.3 percent or about $14.0 billion by 1985.

As far as the Social Security budget is concerned, the slower economic activity with the tax rate increases implies a lower earnings base along with higher unemployment. Therefore, revenues will be lower while the demand for benefit payments will be higher. The analysis shows that between 1984 and 1985 Social Insurance contributions will be $10 billion lower than it would have been without the tax rate increases. On the outlays side, the increase is higher by about $0.1 billion per year. Therefore, the Social Security budget deficit is expected to be larger.

The findings of the analysis suggest that the Social Security system budget problem cannot be solved by more revenues in the form of higher payroll taxes. Alternatively, restraint on the growth of benefits may be more prudent.

ECONOMIC IMPACT OF INCREASES IN SOCIAL SECURITY TAX RATES

1981-1985

Ronald H. Clarke*

INTRODUCTION

The Social Security Amendments of 1977 were enacted to alleviate the impending financing problems of the nation's Social Security system. This legislation, which passed the largest peacetime tax increase in U.S. history, raised both taxes rates and the earnings base to which the tax rates are applied. This was an effort to close the gap between Social Security outlays and receipts. Since then, however, poor economic performance, marked by high inflation and low economic growth, has revived concern about the solvency of the Social Security system.

A number of policy options have been advanced to ensure that the Social Security system has adequate funds to meet its benefit obligations. The short-run options include accounting changes, interfund borrowing, benefit changes, and revenue modifications. For the longer run period, the options include universal coverage to require participation by civilian federal workers and now-exempt state and local employees and the taxation of Social Security income as other income.

This paper analyses one of the short-run options -- payroll tax changes. Two alternative scenarios are considered: 1) Advancing the payroll tax increase slated for 1985 to January 1982 and 2) Advancing the tax increase to January 1983. The details of these assumptions are shown in Table 1.

---

* Director, Forecast Center, U.S. Chamber of Commerce.

TABLE I

SOCIAL SECURITY TAX RATES FOR EMPLOYERS AND EMPLOYEES

(Rates in Percent)

Year	Current Law (OASDHI)	Assumption 1	Assumption 2
1980	6.130	6.130	6.130
1981	6.650	6.650	6.650
1982	6.700	7.050 (a)	6.700 (b)
1983	6.700	7.050	7.050 (a)
1984	6.700	7.050	7.050
1985	7.050	7.050	7.050

(a) Automatic increase slated for 1985 based on statutory formula

(b) Automatic increase slated for 1983 based on statutory formula.

Simulations were performed with the Data Resources Inc. Long Term Econometric U.S. Model (TRENDLONG0981) over the period 1981-1985. In order to construct these simulations, the effective social insurance tax rate was increased by the assumed percent increase in the social security tax rate to reflect equal increases in the tax burden to both employers and employees. The tax rate was increased by 0.7%. Under the first assumption, this increase in the tax rate extends from the first quarter of 1982 (1982:1) to the fourth quarter 1984 (1984:4). This increase represents a static revenue increase in Social Security contributions of about $12 billion per year. In the second simulation, the percent increase extends from 1983:1 to 1984:4 and results in an average static revenue increase of about the same magnitude.

FORECASTS AND POLICY SIMULATIONS

This section reports on three model simulations. The first simulation assumes the short run policy changes contained in the Reagan Economic Recovery Program -- individual and business tax cuts, spending reductions, and firm Federal Reserve monetary policy. This provides our baseline forecast with which each of the two options is compared. The other two alternative forecasts contain the assumptions on changes in the payroll tax rates. The first reflects the increase in payroll tax rates in 1982 and the second reflects the increase in payroll tax rates in 1983. By comparing the paths of economy from the baseline case to those in the alternative forecasts the various policy scenarios can be analysed.

Baseline Forecast

The baseline forecast was generated by year through 1985. The following assumptions were made:

- Personal income taxes are cut nearly $400 billion over the next five years. Personal tax rates are reduced 5% on October 1, 1981, with an additional 10% on July 1, 1982, and another 10% cut on July 1, 1983. The revenue losses of the rate cuts are $25.8 billion in fiscal 1982, rising to $122.7 billion in fiscal 1985. The other tax provisions, such as the reduction in the maximum tax rate on 'unearned' income to 50%, are effective January 1982. The revenue losses of these provisions amount to $0.9 billion in 1982, rising to $35.5 billion in fiscal 1985.

- Corporate income taxes are cut almost $93.2 billion by 1985. The business tax cuts consists of depreciation reform contained in the "15-10-5-3" proposal and increases in the investment tax credits on equipment, structures, and research and development.

- Excise taxes ("windfall profits" taxes) are cut $6.6 billion by 1985.

- The growth in federal nondefense expenditures is reduced from the 14 percent average annual rate of the FY1979-81 period to 5.5 percent over the FY1982-84 period.

- The Federal Reserve is assumed to maintain a tight and consistent monetary policy throughout the forecast period.

The results of the baseline forecast verify the efficacy of the Reagan Economic Recovery program. The growth rate of real GNP increases from 2.0 percent in 1981 to an average of 3.4 percent per year between 1982 and 1985 (See Table 2). This growth is spurred by the rapid improvement in business fixed investment which accelerates from a growth rate of 1.3 percent in 1981 to grow by 5.8 percent in 1985. Productivity growth -- output per man hour in the nonfarm business sector -- also improves, from 1.1 percent in 1981 to an average of about 2.0 percent per year in the following four years. Inflation (CPI) improves steadily over the forecast period from 9.9 percent in 1981 to 6.3 percent in 1985. Consistent with the improvement in economic activity, the unemployment rate declines from 7.4 percent in 1981 to 6.5 percent by 1985.

TABLE 2

U.S. ECONOMIC OUTLOOK: BASELINE FORECAST

1981-1985

(Annual percent change, unless otherwise specified)

	CALENDAR YEARS		
	1981	1985	AVERAGE 1982-1985
Real GNP	2.0	4.1	3.4
Business Fixed Investment	1.3	5.8	4.6
Productivity	1.1	2.4	2.0
Consumer Price Index	9.9	6.3	6.9
Unemployment Rate (%)	7.4	6.5	7.0

Source: Chamber of Commerce of the United States, Forecast Center.

Alternative Forecasts

This section compares the results of the two alternative forecasts with those of the baseline forecast. The first alternative forecast (Alternative I) assumes that the payroll tax rate increase scheduled for 1985 goes into effect January 1, 1982. The second simulation (Alternative II) assumes that the payroll tax rate increase goes into effect January 1, 1983. "A priori", it is expected, beginning in 1982 and 1983 respectively, that these payroll tax increases will have adverse effects on total output, investment, employment, productivity, and inflation. Table 3 presents the comparative results for the baseline forecast and the first alternative forecast. Table 4 presents the results of the baseline forecast compared to the second alternative forecast .

Real Gross National Product. Compared to the baseline case, the growth in real GNP is less improved as a result of the tax rate increase in both alternative scenarios (See Figure 1). Under the first alternative, the losses in real output range from $5.2 billion in 1982 to $14.0 billion by 1985 (See Table 3). This represents a slowdown in the rate of growth of about two-tenths of a percentage point per year over the 1982-1985 period. Under the second alternative, the loss in real output, which begins in 1983, averages over $9.0 billion per year over the 1983-85 period (See Table 4). This is about the same per year loss for the four-year period as under Alternative I. Compared to the baseline case, real GNP growth is slower by about three-tenths of a percentage point per year. This slowdown in overall economic activity is mirroring the retardation in productivity growth due to the payroll tax rate increases in both alternative scenarios.

Table 3

IMPACT OF THE 1982 PAYROLL TAX RATE INCREASE ON THE U.S. ECONOMY
1981-1985

	LEVELS					ANNUAL PERCENT CHANGES				
	1981	1982	1983	1984	1985	1981	1982	1983	1984	1985
REAL GNP (bill $ 1972)										
Baseline	1509.6	1543.9	1595.4	1654.2	1722.0	2.0	2.3	3.3	3.7	4.1
Alternative I	1509.6	1538.7	1587.4	1645.4	1707.9	2.0	1.9	3.2	3.7	3.8
BUSINESS FIXED INVESTMENT (1)										
Baseline	160.4	164.3	172.4	181.3	191.8	1.3	2.4	4.9	5.2	5.8
Alternative I	160.4	163.6	171.2	179.9	189.6	1.3	2.0	4.7	5.1	5.4
Equipment										
Baseline	110.5	113.5	119.8	126.5	134.3	0.4	2.7	5.5	5.6	6.2
Alternative I	110.5	112.9	118.9	125.6	132.7	0.4	2.2	5.3	5.6	5.7
Structures										
Baseline	49.9	50.8	52.6	54.8	57.5	3.1	1.7	3.6	4.1	4.9
Alternative I	49.9	50.7	52.3	54.4	56.9	3.1	1.6	3.2	3.9	4.6
PRODUCTIVITY (2)										
Baseline	0.998	1.014	1.033	1.054	1.079	1.1	1.6	1.9	2.0	2.4
Alternative I	0.998	1.013	1.032	1.052	1.076	1.1	1.5	1.8	2.0	2.3
EMPLOYMENT (Millions)										
Baseline	98.9	100.9	103.3	105.3	107.5	1.6	2.1	2.4	1.9	2.1
Alternative I	98.9	100.8	103.2	105.1	107.2	1.6	1.9	2.3	1.9	2.0
UNEMPLOYMENT RATE (%)										
Baseline	7.4	7.4	7.0	6.9	6.5	-	-	-	-	-
Alternative I	7.4	7.5	7.2	7.1	6.6	-	-	-	-	-
INFLATION (CPI)										
Baseline	2.715	2.927	3.137	3.342	3.553	9.9	7.8	7.2	6.5	6.3
Alternative I	2.715	2.930	3.141	3.346	3.560	9.9	7.9	7.2	6.5	6.4

Source: Chamber of Commerce of the United States, Forecast Center.

(1) Gross fixed private nonresidential investment in billions $ 1972.
(2) Index of output per hour of all persons -- nonfarm business sector.

Table 4

IMPACT OF THE 1983 PAYROLL TAX RATE INCREASE ON THE U.S. ECONOMY
1981-1985

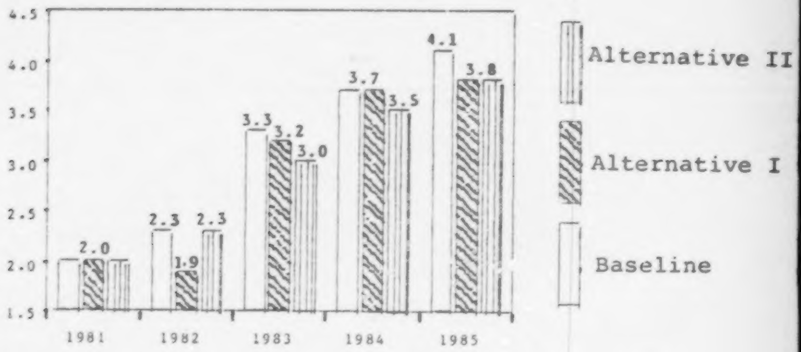
	LEVELS					ANNUAL PERCENT CHANGES				
	1981	1982	1983	1984	1985	1981	1982	1983	1984	1985
REAL GNP (bill $ 1972)										
Baseline	1509.6	1543.9	1595.4	1654.2	1722.0	2.0	2.3	3.3	3.7	4.1
Alternative II	1509.6	1543.9	1589.9	1646.0	1708.5	2.0	2.3	3.0	3.5	3.8
BUSINESS FIXED INVESTMENT (1)										
Baseline	160.4	164.3	172.4	181.3	191.8	1.3	2.4	4.9	5.2	5.8
Alternative II	160.4	164.3	171.7	180.1	189.6	1.3	2.4	4.5	4.9	5.3
Equipment										
Baseline	110.5	113.5	119.8	126.5	134.3	0.4	2.7	5.5	5.6	6.2
Alternative II	110.5	113.5	119.1	125.6	132.7	0.4	2.7	5.0	5.4	5.7
Structures										
Baseline	49.9	50.8	52.6	54.8	57.5	3.1	1.7	3.6	4.1	4.9
Alternative II	49.9	50.8	52.5	54.5	56.9	3.1	1.7	3.5	3.7	4.4
PRODUCTIVITY (2)										
Baseline	0.998	1.014	1.033	1.054	1.079	1.1	1.6	1.9	2.0	2.4
Alternative II	0.998	1.014	1.032	1.052	1.076	1.1	1.6	1.8	2.0	2.3
EMPLOYMENT (Millions)										
Baseline	98.9	100.9	103.3	105.3	107.5	1.6	2.1	2.4	1.9	2.1
Alternative II	98.9	100.9	103.2	105.1	107.2	1.6	2.1	2.3	1.8	2.0
UNEMPLOYMENT RATE (%)										
Baseline	7.4	7.4	7.0	6.9	6.5	-	-	-	-	-
Alternative II	7.4	7.4	7.1	7.1	6.6	-	-	-	-	-
INFLATION (CPI)										
Baseline	2.715	2.927	3.137	3.342	3.553	9.9	7.8	7.2	6.5	6.3
Alternative II	2.715	2.927	3.141	3.347	3.561	9.9	7.8	7.3	6.6	6.4

Source: Chamber of Commerce of the United States, Forecast Center.

(1) Gross fixed private nonresidential investment in billions $ 1972.
(2) Index of output per hour of all persons -- nonfarm business sector.

FIGURE 1

REAL GNP GROWTH
(Annual Percent Change)



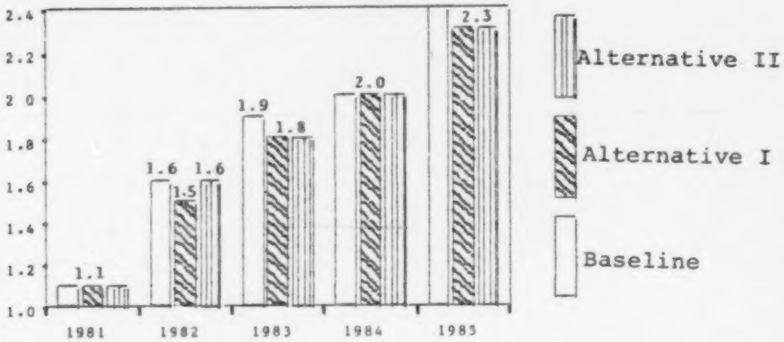
Source: Chamber of Commerce of the United States, Forecast Center.

Productivity. The poor productivity record in the United States over the last decade is attributed in great part to the lack of incentives for business to modernize and expand. The Economic Recovery Tax Act of 1981 provides these incentives. The reduction in personal tax rates and the depreciation reform will encourage capital formation and boost the effective supply of labor. In turn, productivity growth will be enhanced. This expected result is borne out in the baseline forecast as shown in Tables 3 and 4.

By increasing payroll tax rates, either in 1982 or 1983, the disincentives against business expansion will be revived. As a result, productivity growth under Alternative I and Alternative II will be slower than in the baseline forecast (See Figure 2). The growth in productivity -- is forecast to be one-tenth of a percentage point higher by 1985 than it would have been without the payroll tax rate increase (See Tables 3 and 4). In the baseline case, productivity growth is forecast to improve from 1.1 percent in 1981 to 2.4 percent by 1985. Under Alternative I and Alternative II, productivity growth is slower, reaching 2.3 percent by 1985. The poorer productivity performance under the alternative scenarios is as a result of the slowdown in business fixed investment over the forecast period.

FIGURE 2

RATE OF PRODUCTIVITY GROWTH
(Annual Percent Change)



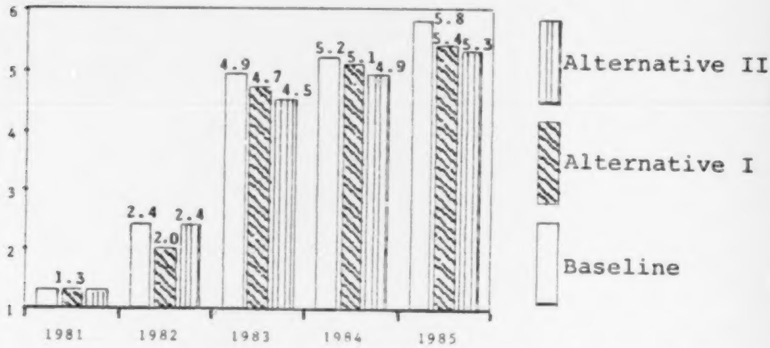
Source: Chamber of Commerce of the United States,
Forecast Center.

Business Fixed Investment. The prospective performance of business fixed investment as a result of the Reagan Economic Recovery program is quite optimistic. The results of the baseline forecast indicate that the growth in investment spending will accelerate from 1.3 percent in 1981 to 5.8 percent in 1985 (See Tables 3 and 4).

However, the disincentive effect of the payroll tax rate increase lessens the positive impact that is afforded by the economic program. By 1985, the growth rate in business fixed investment under Alternative I and Alternative II is four-tenths and one half of a percentage point slower than in the baseline forecast, respectively (See Figure 3). This represents a loss of investment spending of about $1.4 billion per year between 1982 and 1985 in Alternative I, and about $1.6 billion per year between 1983 and 1985 under Alternative II. About three-fourths of the $2.2 billion loss in business spending occurs in nonresidential investment in producers' durable equipment, which by 1985, is $1.6 billion lower in both alternative forecasts than it would have been without the tax change. By 1985, the growth rate in investment in producers' durable equipment in both alternative scenarios is 5.7 percent compared to a 6.2 percent growth in the baseline forecast. Compared to the baseline 4.9 percent growth rate forecast for investment in structures in 1985, the growth rate is forecast to be 4.6 percent under Alternative I and 4.4 percent under Alternative II.

FIGURE 3

NON-RESIDENTIAL BUSINESS FIXED INVESTMENT
(Annual Percent Change)



Source: Chamber of Commerce of the United States,
Forecast Center.

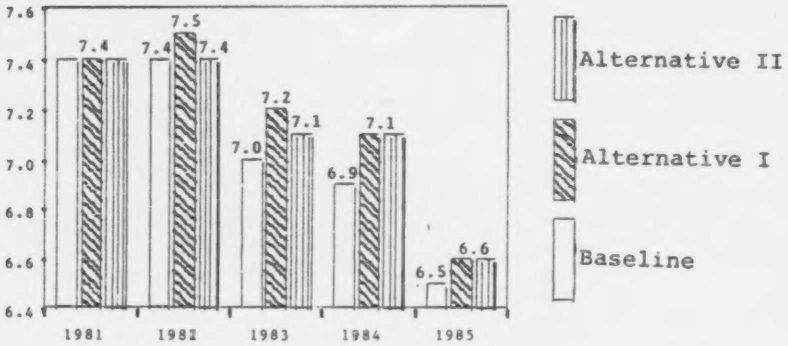
Employment. The impact of the tax reductions in the baseline forecast precipitates the improvement in the employment situation. As overall economic activity accelerates, the unemployment rate will decelerate. Furthermore, the incentive to trade leisure for work is removed by the personal tax rate reductions. Thus, the amount of labor employed and the available supply of labor will increase. In the baseline forecast employment reaches 107.5 million by 1985; an increase of about 9 million jobs over the 1981-85 period. At the same time, the unemployment rate improves from 7.4 percent to 6.5 percent in this period (See Tables 3 and 4).

The payroll tax rate increase assumed in the alternative forecasts will create an unwillingness among employers to hire additional workers in that they now face a higher payroll tax rate per employee hired. More importantly, the higher tax rates faced by employees will cause a reduction in the effective supply of labor. Workers will tend to work less hours as the cost of work rises relative to the cost of leisure. In addition, the rising burden of contributing to the Social Security system relative to the generous retirement benefits will provoke early retirement. Investment in human capital will also be discouraged as the tax increase can be viewed as a reduction in future earnings capacity (the returns to job training and education). The latter retards the quality of work effort -- a negative effect on the supply of labor. These negative effects of the higher tax rates on employment and unemployment are shown in Figures 4 and 5.

Under Alternative I, the higher tax rates result in an average job loss of about 200,000 jobs per year over the 1981-85 period. The resultant job loss per year between 1983 and 1985 under Alternative II is about the same magnitude. This represents a slowdown in employment growth of about one-tenth of a percentage point and a one-tenth of a percentage point increase in the unemployment rate by 1985.

FIGURE 4

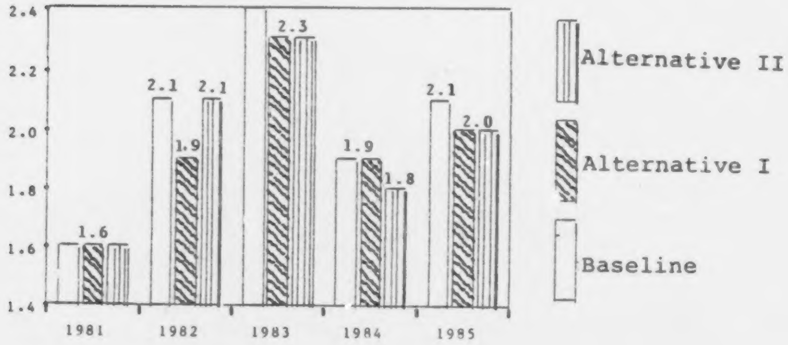
UNEMPLOYMENT RATE
(Percent)



Source: Chamber of Commerce of the United States,
Forecast Center.

FIGURE 5

EMPLOYMENT GROWTH
(Annual Percent Change)



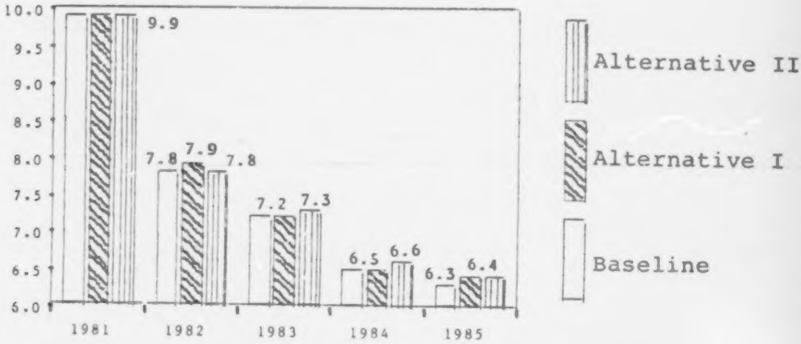
Source: Chamber of Commerce of the United States,
Forecast Center.

Inflation: Inflation in the baseline forecast improves steadily due to the tax cuts and the general improvement in the economic environment. By 1985, the growth in consumer prices falls to 6.3 percent from the 9.9 percent expected in 1981 (See Tables 3 and 4).

Although still optimistic, the improvement in inflation with the imposition of the payroll tax increase in 1982 and 1983 is less than in the baseline forecast by one-tenth of a percentage point (See Figure 6). This could be attributed to the slower productivity growth under Alternatives I and II. This puts upward pressure on unit labor costs which in turn puts upward pressure on consumer prices. By 1985, the growth in consumer prices under both alternatives is forecast to be 6.4 percent compared to the 6.3 percent in the baseline case.

FIGURE 6

RATE OF INFLATION
(Annual Percent Change)



Source: Chamber of Commerce of the United States, Forecast Center.

Social Security Trust Fund Balance. The less optimistic outlook with the imposition of the payroll tax rate increase--particularly for unemployment and inflation -- has serious implications for the Social Security trust fund balance. The higher rate of unemployment means that fewer workers will contribute to the system thereby reducing receipts. Under a higher inflation environment, the higher tax rates will encourage earlier retirement as real incomes diminish. This will fuel unemployment and put pressure on Social Security outlays as the number of beneficiaries increase.

Although the model used in the simulations does not provide sufficient detail to derive revenues and outlays directly related to Social Security, it does provide the broader revenue and outlay estimates from which inferences can be drawn. On the revenue side, the model provides federal Social Insurance contributions, over 75 percent of which are Social Security (OASDHI) contributions. On the outlays side, the model provides federal government transfer payments to persons of which over 60 percent are Social Security payments. The impact of the payroll tax rate increase on the broader aggregates is shown in Table 5.

TABLE 5

BUDGET IMPACT OF THE PAYROLL TAX RATE INCREASE

(Billions $)

	Fiscal Years				
	1981	1982	1983	1984	1985
Contributions to Social Insurance (1)					
Baseline	195.3	217.5	242.0	268.0	306.8
Alternative I		225.4	252.7	279.5	308.7
Alternative II			250.6	279.8	309.1
Transfer Payments to Persons (2)					
Baseline	272.1	291.5	313.4	348.5	383.5
Alternative I		292.0	314.7	349.9	384.3
Alternative II			313.9	349.9	384.5

Source: Chamber of Commerce of the United States, Forecast Center.

(1) Federal Government receipts - contributions to Social Insurance.
(2) Federal Government transfer payments to persons.

In the Alternative forecasts, even though receipts are higher in each of the simulation years, the year-to-year increase during the 1984-85 period is lower than in the baseline case. During that period, the increase in Social Insurance contributions is about $39 billion in the baseline case compared with about $29 billion under Alternatives I and II. This results from the slower GNP growth which is the result of the tax increase. Furthermore, on a per year basis, Social Insurance contributions in the baseline case are forecast to be less than under Alternatives I and II. Without the tax rate increase (baseline) Social Insurance contributions are forecast to increase by $22.3 billion per year over the 1982-85 period. This compares with an increase of $20.8 billion per year under Alternative I during the same period. Similarly, the increase over the 1983-85 period is forecast to be $21.6 billion per year compared to a $19.5 billion per year increase under Alternative II.

On the outlays side, the increase in payroll tax rates does not significantly affect federal transfer payments. In the baseline case, payments are forecast to rise $23.0 billion per year over the 1982-85 period, and $23.4 billion per year over the 1983-85 period. The increase is about $0.1 billion per year higher for Alternatives I and II in the respective periods. By 1985, federal outlays are forecast to be higher under Alternatives I and II by about $0.8 billion and $1.0 billion, respectively.

According to one estimate by the Congressional Budget Office, a 1.0 percent increase in the rate of unemployment could add as much as $11 billion to the trust fund (OASDI) deficit. In both alternative forecasts the unemployment rate is 0.1 percent higher by 1985. Consequently, the OASDI deficit could be $1.1 billion larger than it would have been without the payroll tax rate increase.

The alternative scenarios presented here show that attempts to correct the Social Security trust fund imbalances through 'stepped-up' increases in the payroll tax rates would, in effect, aggravate the problem. Real GNP growth will be slower as a result of lower productivity growth; investment spending will be slower; employment conditions will worsen; and the inflation rate will be higher. Altogether, the poorer economic performance under increased payroll tax rates signals lower Social Security revenues and higher outlays. Therefore, the Social Security trust fund deficit will be larger. Perhaps legislation should concentrate on steps to control the rapid growth in Social Security benefits rather than fiscal policy changes for increasing revenues.

Senator ARMSTRONG. Yes, sir, go right ahead.

Mr. BASSETT. I would like to make two comments, Senator. First, one of the complaints that we have heard today; and I presume yesterday, although I wasn't here—is that so many people feel that this system is unsound and they won't receive their benefits when they become due.

Then the other one we hear is that the taxes are too high and that it costs too much.

It is the kind of dilemma that is going to have to be resolved some way. We are going to have to get the system on a sound basis so people feel confident in it, that they will receive their benefits.

At the same time, keep the taxes as low as possible. The only answer to me, in that regard, is that, therefore, you must reduce benefits in some way. That's the only other item that is available. That's the reason——

Senator ARMSTRONG. Would you agree that perhaps we could avoid reducing benefits if we focused on reducing the rate of increase in benefits?

Mr. BASSETT. Oh, certainly.

Senator ARMSTRONG. I don't mean to nitpick that, but I think that's an important distinction. Someone here, in the last day or two, made a speech in which they waved their arms and said, "Cut, cut, cut." So far as I am aware, there isn't much sentiment in favor of actual reduction, but perhaps with isolated exceptions.

It is a question of moderating or attenuating the rate of increase. Within that context we have the hope of saving the system without large increases in taxes.

Mr. BASSETT. I certainly agree, Senator—chairman.

I think, No. 1, any reductions have to be phased in over a fairly extended period of time. I am opposed to the administration's proposal for an immediate reduction in the 65 to 62 benefit. It is too drastic.

Another observation that I haven't heard today is this: You know, in 1970, social security benefits were increased about 20 percent by Congress. In 1972, they were indexed to the cost of living. All of these were increases in benefits. But if Congress should consider reducing benefits, all of a sudden it becomes immoral, and we have gone back on a promise. You know it is a thing that Congress shouldn't do to decrease benefits. But it seems, it just seems inconsistent that the people that got benefits that were granted in 1972 didn't expect them. And, I think it is only right that on occasion on a planned basis over a period of years, if it is necessary, you are going to have to reduce benefits or increase taxes. And they seem to prefer, I think, that we are going to have to lean more toward the benefit side.

This the reason we are making the recommendations we have at the NAM. One of them is to increase the retirement age to age 68 starting in the year 2000, I think is one way of reducing benefits.

The indexing of the smaller of the two is also—these can be phased in.

Senator **Armstrong**. Well, I thank you very much for your observations.

I thank you all. It is obvious we have some difficult decisions ahead of us.

I will have to tell you what I told some of my colleagues, though. Somebody was pointing out before we met that we really had decisions that would test the wisdom of Solomon and how difficult these choices would be. I pointed out to them that if it were easy, they could get any bunch of dumbbells to do the job—they wouldn't need us.

Yes sir, did you want the last word?

Mr. **Re**. Yes; the last word.

You have heard about the long-term effect of mandatory universal coverage. And I think what I have heard is that the long-term effect is going to be a negative impact on the system.

Again, I would like to quote from the February 1980 background data. And on page 49 there is a statement—the long-range savings—I better put my glasses on, I am getting old too—estimated to result from this proposal is roughly one-half of 1 percent of taxable payroll. Slightly more than half of this savings is estimated to result from elimination of the windfall benefits now attributed to the dual benefit structure. The remainder is due to the revenue surplus resulting from the initial transition to full coverage. So the long-term effect, according to this document, is a savings, one-half of 1 percent of taxable payroll.

Senator **Armstrong**. Thank you.

Thank you all, gentlemen. Thank you for your patience. We are sorry to have interrupted and then delayed your appearance.

[Statements follow:]

STATEMENT
on
SOCIAL SECURITY FINANCING AND OPTIONS FOR THE FUTURE
before the
SUBCOMMITTEE ON SOCIAL SECURITY AND INCOME MAINTENANCE PROGRAMS
of the
SENATE FINANCE COMMITTEE
for the
CHAMBER OF COMMERCE OF THE UNITED STATES
by
LOWELL M. JONES
and
MICHAEL J. ROMIG
July 10, 1981

Good morning. I am Lowell M. Jones, Director of Employee Benefits for the Firestone Tire and Rubber Company of Akron, Ohio and a member of the U.S. Chamber's Employee Benefits Committee. I am accompanied by Michael J. Romig, Director, Human Resources and Employee Benefits Section of the U.S. Chamber of Commerce. We appear on behalf of the U.S. Chamber of Commerce.

We are pleased to have this opportunity to present the business community's views on what steps should be taken to restore economic stability to the Social Security system.

SUMMARY

Social Security is an example of a program that is living beyond its means. Over-expansion combined with recent adverse economic conditions threaten the financial survival of the Social Security system. Through the 70's, high levels of inflation and unemployment in combination with lagging productivity and lagging real wage growth have made visible to the American people the fact that the Social Security program has been over extended and needs to be trimmed back. Trust fund levels have been drawn down to the point that, unless effective action is taken by Congress this year, the Old Age and Survivors (OASI) Trust fund will be out of money late in 1982. Should that happen, the Social

Security Administration will be unable to issue monthly checks to aged retirees, their survivors and dependents.

This impending financial disaster can be averted by Congress taking the following action:

(1) Require all federal, state, and local government employees to participate in Social Security.
(2) Modify the current method of indexation of benefits.
(3) Put into effect accounting and administrative changes to redistribute existing revenues in a manner designed to postpone the exhausting of Social Security trust funds.
(4) Enact the Administration's proposals to:

    A) Change computation points for average indexed monthly earnings from age 62 to 65.
    B) Increase "bend points" in primary benefit formula by 50% (instead of 100%) of wage increases for 1982-1987.
    C) Eliminate benefits for children of retired workers aged 62-64.
    D) Make family maximum provisions of the disability program applicable to survivor and retirement cases.
    E) Require "medical only" determination of disability (i.e., exclude vocational factors).
    F) Increase disability waiting period from 5 months to 6 months.
    G) Require disability prognosis of 24-month duration (instead of 12 months).
    H) Require 30 quarters of coverage out of the last 40 quarters for disability benefits (instead of 20 out of last 40).

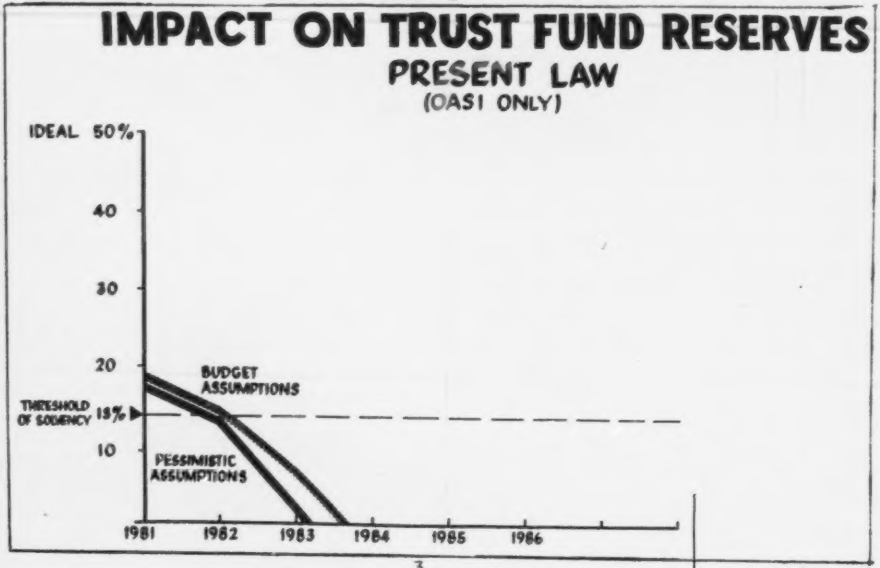
(5) Amend and enact the Administration's proposals to:
   - A) Reduce early retirement benefits, phased in over the next decade.
   - B) Move the date for automatic benefit increases from June to September 1982 and use a 12-month average.
   - C) Eliminate the windfall portion of benefits for persons with pensions from non-covered employment.

THE PROBLEM

As President Reagan recently noted, the Social Security program is teetering on the edge of bankruptcy. All that is needed to push the system over the edge is inaction.

The question before the Congress and each and every American is whether we can afford the Social Security system we have created. The fact that the largest of the three Social Security trust funds, OASI, will be bankrupt by October 1982 -- perhaps sooner if economic conditions worsen -- clearly indicates that we cannot. (See Chart 1).

CHART 1



It is our belief that a safe level of reserves is 50% of the annual outlays. Reserves below 30%, as is now the case, are reasons for concern. With reserves at this level, sudden adverse economic changes quickly drops the fund dangerously close to the 13% threshold of solvency level -- a threshold we will soon cross for the first time if action is not taken.

The short-term financial problems of Social Security are great and the long-term projections are even worse. Although estimates vary, all agree that benefits, as now structured, will exceed payroll tax collections over the next 75 years. The 1981 Trustees report estimates that the combined average deficit for the Old Age and Disability Insurance trust funds may average 1.82% of payroll. In other words, the average payroll tax rate would have to be 1.82% more than is now scheduled by law. (See Table 1)

TABLE 1

SOCIAL SECURITY BOARD OF TRUSTEES
ESTIMATES OF OASDI DEFICITS

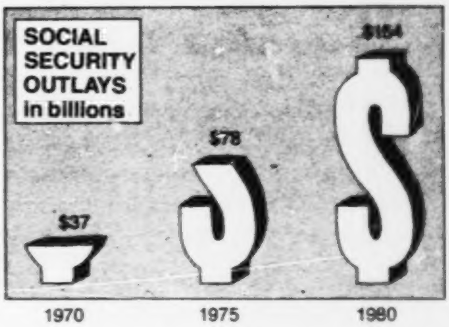
	AVERAGE SCHEDULED TAX RATES	AVERAGE ESTIMATED EXPENDITURES	DIFFERENCE
25 Year Estimate	11.94	11.51	+ .43
50 Year Estimate	12.40	13.87	-1.47
75 Year Estimate	12.40	16.81	-4.41
		75 year average	-1.82

Source: 1981 Report

Since this estimate does not include the Hospital Insurance trust fund projections, the actual deficit is actually somewhat higher. Former Chief Social Security Actuary Haeworth Robertson calculates this deficit to be about 4.39% and warns that it could be much higher if pessimistic assumptions are used.

Despite its current rush toward bankruptcy, Social Security outlays are almost doubling every five years. From $37 billion in 1970 to $78 Billion in 1975 and $154 billion in 1980, (see chart 2).

CHART 2

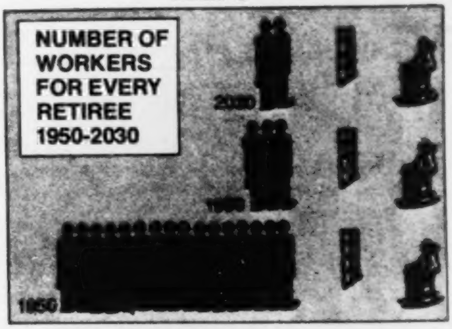


Since 1975 we have been paying out benefits faster than we have been collecting taxes. The excess of income over expenditures was $12 billion from 1975 to 1980 and is expected to be $54 billion for the years 1981 thru 1985. By 1985 the expected deficit could be about $66 billion. Moreover, the actuaries predict that we now have an accrued unfunded liability of $6 trillion. That is, if we did away with the program, we would still be obligated to pay out 6 trillion dollars to people who had already earned benefits.

Social Security is largely a pay-as-you-go retirement system, that is to say, today's workers and employers are taxed to pay benefits to today's retirees just as we have done for 40 plus years and are likely to do for the forseeable future. This makes Social Security taxes extremely sensitive to population and income fluctuations.

In 1940, we had 16 workers for every retiree. Today there are three taxpayers for every retiree and when the post World War II baby crop reaches retirement age that ratio will be down to 2 to 1. These demographic changes further exacerbate our long term problem. (See chart 3)

CHART 3



This problem is compounded by the fact that Social Security is generous to the aged, the disabled and their dependents. Today a fully insured worker -- i.e., someone who has worked as little as 10 years -- is eligible to receive the following benefits on a fully consumer price-indexed and tax free basis:

*Life time pension
*Spouse benefit equal to 1/2 of the primary benefit
*Children's benefits equal to 1/2 of the primary benefit
*Special tuition allowances for children attending college full time
*Similar benefits for those who become permanently disabled
*Hospitalization insurance
*At slight additional cost, insurance for medical fees

Social Security's current value as a floor of protection can further be demonstrated through a comparison of benefits received to Social Security taxes paid on an individual basis. Take, for example, the case of a 1982 retiree entitled to the maximum benefit. Based on retirement beginning in January 1982, that beneficiary would receive $753 a month. A nonworking spouse would receive $376. Their combined monthly benefit would be $1,129, totalling $13,548 per year. Assume further a 10% cost of living adjustment as of July, 1982: that would add $677 for the six remaining months. Since they are entitled to Medicare, the potential exists for an additional $3,000 for the average couple. The grand total: $17,225.00. By way of comparison, this individual would have contributed $14,706 to the program during a 45 year working career. Thus, within 11 months the couple used in this example would have recovered all of their Social Security contributions. (See Chart 4) Add to this the fact that present life expectancy for someone reaching age 65 in 1982 is 14 years and the value of Social Security becomes crystal clear.

CHART 4

MAXIMUM MONTHLY BENEFIT	$753
SPOUSE'S BENEFIT	$376
	$1,129
ANNUAL MAXIMUM BENEFIT	
FOR BOTH	$13,548
5% COLA	$ 677
VALUE OF MEDICARE	$ 3,000
FIRST YEAR BENEFITS TOTAL	$17,225
FORTY-FIVE YEAR FICA TAX TOTAL	$14,706
RECOUP EMPLOYEE TAXES IN 11 MONTHS	
RECOUP EMPLOYEE/EMPLOYER TAXES IN 20 MONTHS	

The couple used in the example would receive about 20 times their contributions, or 10 times that of the employee and employer contributions when cost of living adjustments are included. It should be noted that the time value of money would, of course, lessen to some extent the stark differences used in comparisons of this nature.

(The example uses maximum benefits and taxes. As of July 3, 1981, average Social Security benefits for an aged couple, with both receiving benefits, was $640 a month, or $7680 a year, tax free. Add to that about $3,000 for the average value of Medicare for the couple and the total would still be over $10,000 a year tax free).

It is also important to note the sharp tax increases that have been legislated to pay for these benefits.

Between 1940 and 1950, taxes increased by fifty percent. By 1960 the annual maximum tax had tripled the 1950 rate and almost tripled again over the next ten years. Today's maximum is a 2011 percent increase over the 1950 maximum tax.

Despite these sharp tax increases, the program is in deep financial trouble. As OMB Director David Stockman recently said, "Legislating higher taxes has not solved Social Security's insolvency. Unless excessive costs are curbed, Social Security would eventually consume virtually the entire domestic budget after excluding national defense and interest on the national debt."

SOLUTIONS TO THE PROBLEM

Congress has a number of options available that would solve both the short and long-term financial problems of Social Security -- problems which have been caused by over-expansion, adverse economic conditions and demographic changes. They are as follows:

1. Modify benefits - A number of modifications designed to bring outlays into line with anticipated revenues have been presented to Congress by the Administration. Indexation modification should be added to that list.

2. Find new revenues - Possible sources of additional revenues include increased payroll taxes, general fund financing or extension of coverage to noncovered employments.

3. Change Social Security trust fund accounting and administrative practices - In this category are such approaches as merging the funds, interfund borrowing and reallocation of revenues among the trust funds. These options are designed to delay the day of reckoning and, by themselves, can not resolve the fundamental problem of outlays exceeding anticipated revenues.

CHAMBER RECOMMENDATIONS

It is imperative that Congress meet head-on the challange presented to it by the short and long-term financing problems facing Social Security. The American people are demanding action and that action must come this year. The problems are solvable. We recommend:

(1) Universal coverage - It is necessary to mandate coverage of all federal employees and those state and local government employees not now participating in Social Security. This step would provide a temporary windfall to the trust funds at a time when added revenues are desperately needed to avoid insolvency. Moreover, it would end the withdrawals from Social Security by state and local governments which are eroding the tax base of Social Security and further threatening its solvency.

Ninety percent of the American workforce is covered by Social Security, but about 7,000,000 workers, mostly federal, state and local government employees, are not. Nonetheless, about 80% of the uncovered employees finally qualify for Social Security benefits as a result of working in covered employment at some time in their career or qualifying as a dependent. As a rule, such employees obtain benefits which are about two-thirds of the amount they would have earned if their full career had been in covered employment. Yet, on the average, they pay less than one-third of what career-long covered employees pay into the program.

If mandatory universal coverage were effective January 1982, over $100 billion in additional revenues could be expected by 1987. That is nearly 8% of the projected trust fund outlays for that period, based on the Congressional Budget Office's January 1981 economic assumptions.

We do not propose raiding the retirement trust funds for federal, state and local government employees. Those funds belong to these employees and must be used exclusively to pay promised pensions to both present and future beneficiaries. We do propose, however, that all working Americans should have Social Security as their base line pension. Employer-provided pensions, where available, should be supplemental to, and integrated with, Social Security just as they are now by the majority of private and public sector pensions.

(2) Accounting and administrative changes - Several accounting and administrative changes would provide a partial solution to the short-term problem.

Interfund Borrowing - One of the more promising and least disruptive steps is temporary interfund borrowing. It offers a simple method of insuring against any one trust fund running short of funds because of unexpected economic events. Just four years ago, the Carter Administration estimated that, at the beginning of 1982, the OASI and HI trust fund assets would equal 30% and 47% of yearly outgo, respectively. The Reagan Administration now predicts these assets to be 13% and 61% respectively. Thus, the OASI fund has declined beyond expectations despite a temporary allocation of DI revenues into that fund. HI, on the other hand, has been increasing its assets beyond expectations and could act as a temporary loan source to the OASI fund.

Interfund borrowing would work as follows: Each trust fund could borrow from another whenever its balance fell below 25% of its estimated outlays for the preceeding 12 months. When the borrowing fund's assets reached 30% of its outlays, all of its income beyond that needed to maintain the 30% level would be transferred to the lending fund until the loan is repaid with interest.

This simple procedure is an acceptable way to solve the temporary short-fall of the OASI trust fund and to give the Social Security program the necessary flexibility to meet future financial emergencies. Should Congress wish to pursue this alternative, we recommend it do so on a pilot test basis, and in conjunction with our following recommendation on reallocation.

Reallocation of Revenues - Another alternative is simply to reallocate the income among the three trust funds. The 96th Congress adopted a measure of this sort as Public Law 96-403 in which a portion of the 1980 and 1981 DI revenues were transferred to the OASI fund. The 97th Congress may choose to repeat this step.

While this proposal would overcome the anticipated shortfall in the OASI trust fund, it does not offer the flexibility of interfund borrowing. However, it does maintain the separate identities of the three trust funds and Congressional control over the funds -- factors that many believe are quite important.

Other Accounting Changes - We concur with the General Accounting Office recommendation that the Department of Health and Human Services (DHHS) should require States to make FICA deposits on the same basis as required of private sector employers. Public Law 96-265 required States to make FICA deposits within 3 days of the close of the monthly pay period. If States were to make semimonthly deposits beginning next year, the trust funds could earn about $339 million more in interest during fiscal years 1982-85.

We also recommend that Social Security benefits should be rounded down to the dollar rather than up to the next 10¢ as is currently done. Savings from this change would total about $100 million per year.

(3) Modify indexation - Each June, Social Security benefits are raised by a percentage amount equal to the increase in the Consumer Price Index (CPI) provided that (1) the CPI increase exceeded 3% and (2) Congress has not enacted a benefit increase during the preceeding year.

Since the adoption of this cost of living adjustment (COLA), Social Security has emerged as the outstanding example of the hidden perils of indexation. In this instance, there are two shortcomings. First, CPI itself is flawed in several ways, the most notable of which is its housing component. This has resulted in an overstatement of the actual increase in the cost of living. Moreover, even a flawless CPI is inadequate as an escalator, since it includes price changes that reflect changes in real national per capita income as well as those which reflect inflation. Proper escalation would require, for example, that recent price increases due to supply shocks in energy and food be excluded from the CPI.

Second, earnings on which Social Security taxes depend have not kept pace with inflation. With benefits now pegged to the CPI and taxes pegged to wages, a gap between the two has opened up. As of July 3, 1981, benefits were increased by 11.2% while wages for the same period rose by only 9.1%. One solution to this gap problem would be to index Social Security benefits by rises in the CPI or wages, whichever is smaller. We encourage you to adopt this change. A more fundamental solution is to correct the distortions in the CPI itself. However, there is, as yet, no consensus on how to do this.

(4) Enact certain administration proposals - The Chamber fully supports the proposals outlined by the Administration to:

(a) Change computation points for average indexed monthly earnings from age 62 to 65.

(b) Increase "bend points" in primary benefit formula by 50% (instead of 100%) of wage increases, 1982 -1987.

(c) Eliminate benefits for children of retired workers aged 62-64.

(d) Make family maximum provisions of the disability program applicable to survivor and retirement cases.

(e) Require "medical only" determination of disability (i.e., exclude vocational factors).

(f) Increase disability waiting period from 5 months to 6 months.

(g) Require diability prognosis of 24-month duration (instead of 12 months).

(h) Require 30 quarters of coverage out of the last 40 quarters for disability benefits (instead of 20 out of last 40).

All the foregoing proposals are consistent with our conviction that the growth of Social Security's costs must be contained if we are to solve its serious financial problems. These proposals are well thought out and would contain that growth in costs in a manner not inconsistant with the goals and responsibilities of Social Security. They are designed to reduce the adverse effects upon the system of past liberalizations and should be enacted.

(5) Amend and enact certain administration proposals - The following Administration proposals would be improved with certain modifications.

(a) Setting a benefit rate of 55% of primary benefit for those who retire (and 27% for spouses) at age 62, beginning next January. Although the timetable is too abrupt, we concur in the Administration's objective of not encouraging early retirement. While it is actuarially appropriate to lower the benefit for age 62 retirees, it is equally important to raise the retirement age from 65 to 68 to recognize increased life expectancies.

Thus, we would support full benefits at 68 with actuarial reductions for retirement before that age. For example, a 62-year-old would be eligible for a benefit equal to 64% of the full benefit at age 68 rather than 55% of the full benefit at 65 as suggested by the Administration.

Most importantly, we would delay implementing the proposals until about 1990, and phase them in over a period of years rather than abruptly imposing them next year. This would allow individuals and their employers time to make compensating changes in their plans and in their benefit packages without major cost implications or disruption of long-planned retirements.

(b) Move the date for automatic benefit increases from June to September 1982 and use a 12-month average. As stated earlier, a fundamental revision of the Social Security COLA provision is absolutely essential. The problems facing Social Security are of such magnitude that it seems entirely appropriate to call upon current beneficiaries to help solve them. Since the COLA provisions played a significant role in creating the problem, correcting the overescalation of benefits can now help resolve it. Hence, we recommend that, in addition to changing the effective date of the COLA, Congress change the formula to the lesser of the increase in yearly wages or prices. Both changes should become effective in 1982.

(c) Eliminate the windfall portion of benefits for persons with pensions from non-covered employment to reduce the revenue loss to Social Security as a result of "double-dipping". While we support this proposal, it merely addresses the symptoms and ignores the real problem which is the lack of mandatory coverage of federal, state and local government employees. Accordingly, we recommend that the Administration proposal be amended to require mandatory coverage of all public sector employees, with coverage for new employees beginning as early as possible. For current workers, this would require integration of civil service and Social Security benefits, which is the normal practice in the private sector.

TAX INCREASE OR GENERAL REVENUES

Although the Chamber has traditionally supported payroll tax increases to meet benefit obligations, we do not recommend this course of action because of the adverse economic effect that a payroll tax increase would have and its inconsistency with the President's economic recovery program.

We remain fundamentally opposed to general revenue financing in any form. We would oppose both direct infusions from the Treasury, including loans, and indirect methods such as income tax credits or deductions.

However, we do recommend the immediate extension of Social Security to uncovered employees.

CONCLUSION

If the above recommendations are enacted, it will not be necessary to increase the scheduled tax rates or to supplement current revenues by the infusion of general revenues. The accounting changes will, by themselves, postpone the exhaustion of the OASI trust fund. As Table 2 illustrates, the savings from the proposed benefit modifications -- which we project to be roughly $55 billion by 1987 -- plus an increase of $101 billion in revenues resulting from universal coverage -- will return Social Security to a healthy financial basis. Rather than a $40 - $60 billion deficit as now predicted, it would enjoy a $96 - $116 billion surplus by 1987.

Our commitment as employers to the principles of Social Security and the commitment of Congress as a responsible trustee for the retirement security of elderly Americans should cause employers and the Congress to work together for the enactment of the realistic program we are advocating to save and strengthen Social Security.

TABLE 2

ESTIMATED SAVINGS AND REVENUE INCREASES IF CHAMBER RECOMMENDATIONS ARE ADOPTED

(BILLIONS OF DOLLARS)

	1982	1983	1984	1985	1986	5YEAR TOTAL
Universal Coverage	$15.7	$18.0	$19.7	$22.6	$25.0	$101.0
COLA Modification	3.8	4.4	5.1	5.6	6.3	25.2
Rounding Benefits	n.a.	.1	.1	.1	.1	0.4
State Deposits	n.a.	n.a.	n.a.	n.a.	n.a.	0.3
Change Computation Points	n.a.	.1	.1	.3	.5	1.1
Bend Points	n.a.	.2	.5	1.1	1.9	3.6
Children of Retired Workers	n.a.	.2	.4	.6	.6	1.8
Family Maximums	.1	.4	.6	.7	.9	2.7
Medical Only Determination	.2	.9	1.4	2.0	2.5	7.0
DI Waiting Period	.1	.3	.3	.3	.3	1.3
24 Month Prognosis	n.a.	.3	.6	.8	.9	2.6
30 Quarters for DI Coverage	.2	.8	1.7	2.7	3.5	8.9
	$20.10	$25.70	$30.50	$36.80	$42.50	$155.9

Sources: Office of The Actuary, Social Security Administration
Office of Management and Budget
Congressional Budget Office
General Accounting Office

NAM National Association of Manufacturers

STATEMENT OF

Preston C. Bassett, Consulting Actuary

on behalf of

THE NATIONAL ASSOCIATION OF MANUFACTURERS

on

Social Security Financing and Options for the Future

before the

Subcommittee on Social Security and Income Maintenance Programs

Committee on Finance

United States Senate

July 10, 1981

1776 F Street, N.W. • Washington, D.C. 20006 • (202) 626-3700

Summary of

Statement of

Preston C. Bassett, Consulting Actuary

on behalf of

The National Association of Manufacturers

on

Social Security Financing and Options for the Future

before the

Subcommittee on Social Security and Income Maintenance Programs

Committee on Finance

United States Senate

July 10, 1981

Mr. Chairman and members of the Subcommittee, my name is Preston C. Bassett, and I am a consulting actuary. I am before you today representing the National Association of Manufacturers. The NAM is an organization of nearly 12,000 members of every size and industrial classification located in every state. Our members employ 85 percent of the workers in manufacturing employment and produce over 80 percent of the Nation's manufactured goods.

Many of our members provide some form of retirement program for their employees and nearly all are covered by the Social Security system. The NAM consistently suppports the Social Security program in its role as providing a basic floor of economic protection. We strongly believe that the financing should continue to be self-supporting through separate taxes paid equally by employers and employees, and general revenue financing should be avoided.

The NAM believes that revision in the benefit, coverage, and financing aspects of the Social Security system is essential in order to preserve the integrity of the program and to restore the public's confidence in it.

INDEXATION OF BENEFITS

NAM's foremost recommendation in the benefit area is to change the method of indexation for beneficiaries on the roll. Average wages have not risen as quickly as prices over the last two recessionary periods. During these times Social Security benefits have been protected by automatic increases (reflecting the rise in the CPI) which have been larger than average wage increases.

Specifically, the benefit increase should be determined from the smaller of the wage increase or the price increase, rather than solely on the basis of the latter.

Changing the method of indexation would prevent retirees from gaining disproportionately to workers over these periods. Additionally, and of greater significance here today, it would generate substantial savings to the Social Security system.

RETIREMENT AGE

The NAM also believes that Congress and the Administration should give serious consideration to raising the normal retirement age from age 65-68. We feel that increasing the eligibility age for receipt of full retirement benefits should be phased-in beginning around the year 2000. This is similar to the approach taken by the National Commission on Social Security.

UNIVERSAL COVERAGE

Universal coverage can solve many anomalies and inequities as some non-covered government employees lose out because of gaps in their Social Security coverage.

To achieve this end, the NAM recommends that HI coverage be extended to federal employees, to be effective next year, and that universal coverage of OASDI-HI be extended to new federal employees as it becomes practicable. The extension of HI coverage to federal employees would bring approximately $2.5 billion annually in additional revenues to the Social Security system. We also endorse, in principle, extending HI coverage to state and local employees, recognizing that there may be a question of constitutionality.

CONCLUSION

The NAM, in its general support of the Social Security program, is very concerned about the mounting fiancial problems that threaten the operation of the system in the short and long run. We commend the Subcommittee for taking prompt action on this crucial issue, and we thank you for the opportunity to appear. We hope that our comments will be useful to the Subcommittee in its examination of Social Security financing and options for the future and that our complete statement be included in the record. I welcome your comments and will try to answer any questions you may have.

Statement of
Preston C. Bassett, Consulting Actuary
on behalf of
The National Association of Manufacturers
on
Social Security Financing and Options for the Future
before the

Subcommittee on Social Security and Income Maintenance Programs
United States Senate
July 10, 1981

Mr. Chairman and members of the Subcommittee, my name is Preston C. Bassett and I am a consulting actuary. I am before you today representing the National Association of Manufacturers. The NAM is an organization of nearly 12,000 members of every size and industrial classification located in every state. Our members employ 85% of the workers in manufacturing employment and produce over 80 percent of the nation's manufactured goods.

Many of our members provide some form of retirement program for their employees and nearly all are covered by the Social Security system. The NAM consistently supports the Social Security program in its role as providing a basic floor of economic protection. We strongly believe that the financing should continue to be self-supporting through separate taxes paid equally by employers and employees, and general revenue financing should be avoided. For these reasons, our members have a vital interest in the Subcommittee's work regarding Social Security financing.

The NAM believes that revision in the benefit, coverage, and financing aspects of the Social Security system is essential in order to preserve the integrity of the program and to restore the public's confidence in it.

Benefit Changes

The modifications which we believe should be effected in this area would reduce the benefit outgo--both by eliminating certain benefits not originally intended within the framework of the Social Security system and by preventing benefits from increasing as rapidly as they would under present law. NAM's foremost recommendation in this area is to change the method of indexation for beneficiaries on the roll.

Average wages have not risen as quickly as prices over the last two recessionary periods. During these times Social Security benefits have been protected by automatic increases (reflecting the rise in the CPI) which have been larger than average wage increases. Specifically, the benefit increase should be determined from the smaller of the wage increase or the price increase, rather than solely on the basis of the latter. Changing the method of indexation would prevent retirees from gaining disproportionately to workers over these periods.

Additionally, and of greater significance here today, it would generate substantial savings to the Social Security system.

If this change were made, it might be desirable to consider a catch-up provision in the event that wages rise more rapidly than prices in future years after having done the reverse previously. Thus, over the long run, the adjustment would continue to be on the basis of prices, but there would be a smoothing-off of the increases in "unusual" periods when prices rise more rapidly than wages.

The NAM also believes that Congress and the Administration should give serious consideration to raising the normal retirement age from age 65 to 68. We feel that increasing the eligibility age for receipt of full retirement benefits should be phased-in around the year 2000. This is similar to the approach taken by the National Commission on Social Security.

In addition to the above, the NAM is generally very supportive of the Administration's efforts in dealing with the Social Security financing crisis. The NAM endorses the following benefit revisions to the Social Security system proposed by the Administration:

-- eliminating benefits for children of retired workers aged 62-64. It would serve as an incentive for workers to stay in the work force until, at least, age 65, when benefits would remain payable to children of retirees.

-- applying family maximum provisions of the disability program to survivor and retirement cases. The benefits in these cases would then be more closely related to the worker's previous take-home pay.

-- eliminating the windfall portion of benefits for persons with pensions from non-covered employment. While the NAM supports this proposal, we believe that this is an inadequate solution to the problem of the lack of coverage of federal civil employees. As we will discuss further on in our statement, we recommend that coverage be extended on an appropriate basis so that all persons in the paid labor market are covered by Social Security.

-- requiring a "medical only" determination of disability. This change would make benefits more directly related to medical history and would help restore the disability program to its original intent.

-- increasing the disability waiting period from five months to six months. This proposal would restore the six-month waiting period in effect before the program was liberalized in 1972. The increase to six months would also conform with the terms of most private disability insurance programs.

-- moving the date for automatic benefit increases from June to September and using a 12-month CPI average. By making the benefit increases coincide with the fiscal year, and the CPI computation cover a full year, the increase will more accurately reflect economic trends and measure the cost of living in a period ending closer to the beginning of the benefit increases.

Coverage Changes

There are several reasons why all persons in paid employment should be covered under the Social Security program. Basically, if such coverage is good for all workers in the private sector-- and NAM believes that it is -- then most certainly it is good for government workers. Similarly, if pension plans for private employees have been adjusted so as to coordinate successfully with Social Security -- and they have been -- then too, this can be done for pension plans for public employees. In addition, universal coverage can solve many anomalies and inequities as some non-covered government employees lose out because of gaps in their Social Security coverage.

To achieve this end, the NAM recommends that HI coverage be extended to federal employees, to be effective next year, and that universal coverage of OASDI-HI be extended to new federal employees as it becomes practicable. The extension of HI coverage to federal employees would bring approximately $2.5 billion annually in additional revenues to the Social Security system. We also endorse, in principle, exending HI coverage to state and local employees, recognizing that there may be a question of constitutionality.

The NAM also urges Congress and the Administration to consider disallowing withdrawal from the Social Security system after a certain period of time. We believe that measures should be taken to prevent currently-covered state and local governments and non-profit organizations from opting out of Social Security.

Lastly, in the coverage area, NAM supports the Administration's proposal of covering under Social Security all sick pay made by an employer for the first six months of illness. This change in coverage would eliminate the administrative burden experienced by some employers in keeping accurate records of sick pay.

Financing Changes

One essential change to ameliorate cash-flow problems of the OASI Trust Fund, at least for 1982 and possibly for 1983 as well, is to authorize inter-fund borrowing repayable with appropriate interest. The NAM also supports reallocation of the OASDI-HI tax rates, especially the HI ones, so as to give a larger portion to OASI for the short-range cash flow problems. It is important that utilization of both these financing mechanisms be permitted.

As stated earlier, financing should continue to be self-supporting through separate taxes paid equally by employers and employees. Further, general revenue financing should not be necessary, and should be avoided. Nor should there be any loans from general funds. The NAM recommends that consideration be given to advancing the 1985 tax rate to 1983 if absolutely necessary to prevent resorting to general revenues.

Conclusion

The NAM, in its general support of the Social Security program, is very concerned about the mounting financial problems that threaten the operation of the system in the short and long run. We commend the Subcommittee for taking prompt action on this crucial issue and we thank you for the opportunity to appear. We hope that our comments will be useful to the Subcommittee in its examination of Social Security financing and options for the future. I welcome your comments and will try to answer any questions you may have.

SUMMARY SHEET
TESTIMONY OF JOHN RE
COUNCIL OF STATE CHAMBERS OF COMMERCE
JULY 10, 1981
SOCIAL SECURITY FINANCING

1. General Revenue financing not in the best interest of Social Security.

2. Support inter-fund borrowing as a useful tool to overcome short-term problems.

3. Further tax increases should be rejected.

4. Support elimination of inappropriate benefits and moderate reduction of benefit levels to contain future costs.

5. Changes reducing benefits should be phased in over a period of time.

6. There is a need to modify indexing methods by limiting it to the lower of CPI or the wage index.

7. Retirement age should be raised on a phased in basis beginning in the year 2000.

8. Universal coverage should be extended to all workers with proper intergration with other plans.

TESTIMONY OF JOHN RE ON BEHALF OF THE
EMPLOYEE BENEFITS AND RELATIONS COMMITTEE OF THE
COUNCIL OF STATE CHAMBERS OF COMMERCE
BEFORE THE
SUBCOMMITTEE ON SOCIAL SECURITY AND
INCOME MAINTENANCE PROGRAMS
COMMITTEE ON FINANCE
JULY 10, 1981

Mr. Chairman, Members of the Subcommittee, my name is John Re. I am Staff Tax Administrator for U.S. Steel Corporation and Chairman of the Social Security Subcommittee of the Employee Benefits and Relations Committee of the Council of State Chambers of Commerce, an organization comprised of 34 State and regional chamber organizations. Ordinarily our procedure in presenting testimony is to speak with the specific endorsement of those member organizations. Time restrictions, however, have not allowed us to follow that procedure in this instance; however, this testimony is consistent with Council policy, and for those proposals where a policy does not exist, it meets with the general consensus of those members who follow Social Security financing.

We appreciate the opportunity to appear before you today as we believe that action is needed and is needed quickly to once again place Social Security on an unquestionably sound basis. This will assure today's younger workers that the Social Security program they are now supporting with their tax dollars will supply them with appropriate benefits upon their retirement. This Subcommittee should be commended for its decision to hold hearings as quickly as you have on Social Security. We believe this demonstrates the Subcommittee's determination to fully examine the financial problems of Social Security and, therefore, be in a position to act as you perceive action to be advisable.

The only way to avoid unbearable taxes is to steer away from the traditional politics of Social Security, and give due consideration to balancing the Social Security budget so that correction of some of the system's deficiencies caused by the changing roles of men and women may be addressed. Mr. William Agee, Chairman of Bendix Corporation, was quoted in a recent issue of Fortune Magazine as saying that "Procrastinating until the burden forces the breaking of promises will only make the problem worse. Young and old will be pitted against one another in a fearful battle over the remains of a shrinking economy." We agree with that assessment.

Financial Conditions

We note that many, if not all, witnesses before this Subcommittee have suggested that action is necessary on your part because the program is experiencing financial difficulties. These difficulties are both short and long range, with the long range forecast being especially onerous. We would emphasize the outline given by the Secretary of Health and Human Services before this Subcommittee on February 19th when he stated that "The 1980 report of the Boards of Trustees of the Social Security trust fund shows that over the next 25 years (1980-2004) the old-age survivors and disability program will run a surplus averaging 1.19 percent of payroll. For the second 25 years (2005-2029) we have a roughly equal deficit (1.17 percent of payroll). This is followed by a very significant deficit of 4.58 percent of

2030 to 2055. The average of these figures is a 1.52 percent deficit for the full 75-year projection period."

"Another way of looking at the longer range is to trace the projected trust fund balances. The 1980 Trustees Report showed the combined assets of the OASDI trust fund rising from 23 percent to annual outlays in 1980 to 335 percent of outlays in 2010 and declining thereafter until the funds would be unable to pay benefits in 2030 or so."

The deficits projected in the 21st century are largely the result of projected demographic changes. The combination of projected lower mortality rates, especially among the aged, the retiring of the "baby boom" generations, and of combined lower fertility rates causes the ratio of workers of beneficiaries to shift from about 3 to 1 today to about 2 to 1 in the year 2035.

Proposals

There have been proposals made in three general areas for resolving the financial problems of Social Security.

A. General Revenue Financing - One of these is the use of general revenue financing. It is our belief that general revenue financing is not in the best interest of Social Security. The Social Security Program must contain the mechanism of self financing by the payroll tax whereby participants are informed through payroll deduction as to their involvement. We believe that the biggest single factor in the public's great acceptance and support of Social Security over the years is the fact that people view Social Security as an earned right and not welfare. General revenue financing would weaken this perception and should, therefore, be rejected.

We believe that interfund borrowing can serve as a very useful tool to overcome short-term problems and would recommend its use on a limited basis. It must be recognized, however, that the fact that interfund borrowing is necessary indicates a problem either with tax rate allocations, the funding of the program, or excessive benefits. Interfund borrowing should never be looked at as a solution but only as a method for buying time.

B. Increase in Taxes - Another option is to increase taxes. This Subcommittee is already aware of the current scheduled increases in Social Security taxes over the next several years. We also believe that you are painfully aware of the public's reaction to this year's tax increase. We feel that our current tax rates have reached the maximum acceptable levels. Further increases are not the solution and, like general revenue financing, should be rejected.

Proposals are made periodically, however, to break away from the historical 50% employer and 50% employee method of financing Social Security. We strongly oppose these proposals on the grounds that they are attempts to hide the true cost of Social Security, they would increase taxes on an already overtaxed, overregulated business community and undermine the social insurance concept of Social Security.

The concept of parity is basic to the system and should not be changed.

Periodically proposals are made to increase the taxable wage base over and above the mandated increase as another way to increase revenues into the system. We are opposed to this since future benefits that have to be paid are also increased. Furthermore, raising the wage base may result in upper income groups reducing private savings and this the maount of capital formation in the economy. Any increase in cost of the program should be met primarily through increased tax rates rather than through the "hidden" avenue of an expanded wage base.

While we support the Administration's proposal for a reduction in the long range Social Security taxes, we feel that there must first be a balancing between fund income and outgo. We cannot support taxation of the first six months of sick pay.

C. Reduce and/or Eliminate Benefits - One of the more difficult options available is to reduce and/or eliminate certain benefits. We feel, however, that this is the most appropriate course of action and strongly recommend that inappropriate benefits be eliminated and that there be moderate reduction in benefit levels to contain future costs. Our basic policy is that OASDI should represent minimum layer of protection. We feel that some reductions can be obtained without destroying this level of protection for most workers.

We feel that it is indeed appropriate to eliminate the "unearned benefits" (student, death and minimum benefit) immediately and would add our support to the legislation embodied in the budget reconciliation proposals recently cleared by the Senate and the House. We are certain that the two houses will be able to reconcile the differences that do exist and that we will be able to support the final package.

There has been a number of other proposals made by the Administration and the House Ways and Means Social Security Subcommittee for reducing benefits which we generally can support. However, we suggest certin changes be phased in over a longer period of time in order that the rules are not changes in the middle of the game. However, interim changes may be desirable.

In this regard, we would join the many who would suggest that the current indexing methods used for determining the benefit formula and for escalating benefits and the taxable wage base need to be modified if the program is to return to fiscal soundness.

To accomplish these goals will take time; however, we feel that in the interim, indexation should be limited to the lower of the CPI (or some other appropriate index) or the wage index for adjustments to the "bend points," benefits and the taxable wage base.

We feel that the Administration's proposal to increase bend points by 50% instead of 100% of wage increases for the period 1982-1987 is much too rapid. As a modification we would accept increasing the bend points by 50% for two years ('82-'83) and then increase by the lesser of the CPI or wage index increases.

There are numerous alternatives in the manner in which benefits, etc. can be indexed. We believe that Congress must review this aspect and select the method that would best relate the program's expected costs to revenues. It is noteworthy that one of the alternatives, i.e., indexing based on prices, would have lessened the uncertainty over the future financing of the Social Security system. Finally, Congress may also wish to review the weighting of the benefit formula which is progressive and of a welfare nature at the low end of the benefits table.

D. Increase the Retirement Age - Another crucial aspect of the program is the determination of the retirement age. We believe that because of the fact that people on average live longer, healthier lives today than they did when the retirement age was first calculated, the retirement age should be raised on a phased-in basis. In view of Social Security's financial problems it is not clear why such early retirement should be a matter of right. We, therefore, believe it would be appropriate to raise the ages from 62 and 65 to 65 and 68 as has been suggested by others beginning in the year 2000. We believe this action now would serve as a safeguard against future contingencies and, if it is determined at a later date that this action was not necessary, Congress could act to reduce the retirement age.

Benefits for early retirees could be reduced below the 80% for a person retiring at age 62; however, the Administration's proposal of 55% is too great of a reduction as it does not approximate a reduction based on estimated actuarial assuptions.

Substantial retirement from active employment should be maintained as a basic condition of eligibility.

Further Adjustments

A. Universal Coverage - We strongly believe that coverage under Social Security should be extended to all workers (including governmental employees) for the following reasons:

1. Members of Congress and all Federal employees should participate; otherwise the public will become increasingly contemptuous about their non-participation.

2. The employees currently excluded from coverage do not have the basic plan of protection nor do they share in the concept inherent in the Social Security program of transferring funds from those employed to those who no longer are employed.

3. A large percentage of employees working in non-covered employment are covered under Social Security based on employment and/or self-employment in a second job ("moonlighting"). These employees are unjustly taking

advantage of the "welfare" aspect of Social Security in which the benefit structure is heavily weighted in favor of those with low covered income or for low years of coverage. They, in fact, receive a windfall because their benefits will far exceed their contributions.

4. The result of the above "windfall" to some is that others in the system--often those who have much less total income --have to pay higher Social Security taxes to support those who enjoy this windfall gain.

5. There are gaps in benefit coverage for many individuals who have worked under both Social Security and the civil service retirement systems.

6. Finally, the non-covered do not share in the cost of income redistribution inherent in Social Security.

This mandatory coverage extension should be accompanied by proper integration of OASDHI benefit rights with those provided by other special pension plans. We believe that a public relations program should be started to educate public employees to the advantages of Social Security and that coverage would not eliminate or destroy their public pensions.

B. Waste, Fraud and Mismanagement - A recent article in Readers Digest entitled, "Stormclouds Over Social Security", reported that between January and July 1978 SSA sent almost 1 million beneficiaries some $536 million more than they should have received. The article continued that GAO reported only $207 million was recovered. In view of these occurrences, we would recommend review of Mr. Jack Futterman's report to the National Commission on Social Security dated July 1980 which highlights the SSA as an "ailing mechanism for the administration of these programs". There can be no public acceptance of the payroll tax when waste, fraud and mismanagement are evident.

Conclusion - We have tried through this testimony to outline ways which we believe could raise receipts and decrease outlays for both the short and long-term. We urge this Subcommittee to consider these recommendations throughout your future deliberations. They are, we believe, necessary for a financially sound Social Security system. As the Subcommittee will note, most of our recommendations are for decreasing outlays which is not an easy thing to vote for. However, today's younger workers are entitled to be able to expect to collect benefits for their Social Security dollars. Congress must face up to both the short and long-term issues, which is necessary to keep the program fiscally sound and to avoid widespread public apprehension. It is our belief that through the changes we suggest an unquestionably sound financial base for the Social Security system will be in place for today's beneficiaries and workers.

Finally, we are concerned over the widespread lack of understanding among the public about the Social Security program. We believe that an informed public would be much more receptive to proposed changes and would in fact demand changes.

Summary Statement

James D. "Mike" McKevitt

Director, Federal Legislation

National Federation Of Independent Business

Before

Senate Social Security Subcommittee

July 10, 1981

Mr. Chairman, on behalf of the National Federation of Independent Business and the more than 500,000 small-business men and women who are members of NFIB, I want to thank you and the other members of the Social Security Subcommittee for giving us this opportunity to present our views.

As has been dramatically pointed out during the previous days of hearings, no government activity directly affects the lives of more Americans than Social Security. One of seven Americans now collects a Social Security check. Nine of ten American workers pay Social Security taxes to provide those checks.

All the money for the program, the original retirement program and the more recently added income-transfer programs, comes from but one source: the employer/employee payroll tax...the F.I.C.A. column on a worker's payroll check. No other source is used.

Those familiar with the labor-intensive small business sector will not be surprised, therefore, that most small businesses pay more in payroll taxes than in any other kind of tax.

Clearly, constant tax increases, particularly payroll tax increases, are unacceptable. They retard employment growth and reduce the amount of money saved or invested, hampering economic recovery.

Small business in America has been responsible for two-thirds of the jobs created in the United States over the past decade. But ever-increasing F.I.C.A. taxes are a real threat to the job-creating potential of small business in the 1980's. Those who suggest that the Social Security program could be bailed out again with another stop-gap increase in payroll taxes must be made aware that the results of such an approach would be disasterous because neither the small-business community nor the economy as a whole can afford it.

-more-

Yet something must be done, and soon, because now, almost without realizing it, Social Security has become an economic time bomb ticking away within our society.

Inflation, unemployment and an unrelated combination of increasing benefits and shifting population patterns threaten its financial stability. The system is going broke and the ever-increasing taxes needed to finance its inexorable growth are slowly undermining the job-creating capacity of employers, especially the nation's small businesses. As a result, the country is faced with angry taxpayers, anxious beneficiaries and long-term obligations on the U.S. Treasury that are staggering.

As I pointed out in my written testimony, a workable - and, yes, equitable - solution does exist.

We call our proposal the NFIB Equity Reform Plan. As soon as actuarial studies are completed, we will submit the plan to this subcommittee for its consideration.

At the heart of the proposal is the separation of the Social Security annuity and transfer functions. The idea is to provide Social Security annuities to retirees based entirely on the amounts they and their employers have contributed plus interest earned. Benefit levels would not be affected by such things as the earnings test and number of dependents. For example, if the average person at retirement had $60,000 in his or her Social Security annuity account and life expectancy was 10 years beyond retirement, that person would draw a $6,000 per year ($500 a month) benefit. Annuities would continue to be financed by F.I.C.A. taxes. Nothing could be simpler or more equitable.

-more-

This does not eliminate the need for social transfer payments for those who are poor or who for other reasons need help. A supplemental social transfer program - based on need - would provide such benefits from general revenues.

Our plan would accomplish two major objectives: 1) guarantee every working American a fair return, upon retirement, on all of the money he or she paid into the system over the years, and 2) establish a fair mechanism for providing retirement benefits to those who have little or no means of subsistance other than the entitled annuity.

Under current law, social transfers are paid to virtually every retiree, whether needed or not. The retiree with a large private pension and two homes receives a social transfer just like the poverty-stricken retiree.

Under our plan, social transfer payments to the non-poor are eliminated. The effect is a net cost reduction. Further, benefit equity is created. Everyone, including the young, can expect a fair return on his or her Social Security tax dollar. If that return plus other income and assets prove insufficient, affected elderly would draw resources from a program specifically designed to help them. Finally, programmed increases in F.I.C.A. taxes, a particularly severe tax for small business, could be reduced.

Because none of the approaches available to Congress will make everyone happy, I suggest that you apply two basic criteria: fairness, and economic soundness. The NFIB Equity Plan meets both tests.

Today, young workers wonder whether they will receive retirement benefits. Those retired or soon to retire are nervous about the precarious financial state of the Social Security system. Small-business people defer hiring because of prohibitive payroll taxes. Changes must be made in the system, now, or we will be confronted soon by a polarized society in which the young are pitted against the old, the taxpayer against the benefit recipient, the worker against the retiree, the employed against the unemployed.

But if we act now to implement meaningful reform measures, we can restore to our Social Security system the public confidence and support it once enjoyed and still deserves, and at the same time lift a significant financial burden from the small-business community to permit expansion of this vital, job-producing segment of the economy.

X X X

NFIB National Federation of Independent Business

STATEMENT OF

JAMES D. "MIKE" MCKEVITT

Director of Federal Legislation

National Federation of Independent Business

Before: Senate Social Security Subcommittee

Subject: The NFIB Social Security Equity Reform Plan

Date: July 10, 1981

Federal Legislative Office: 490 L'Enfant Plaza East, S.W., Suite 3206, Washington, D.C. 20024
Telephone (202) 554-9000 • Home Office: San Mateo, California

No government activity directly affects the lives of more Americans than Social Security. One of seven Americans now collects a Social Security check. Nine of ten American workers pay Social Security taxes to provide those checks.

But now, almost without our realizing it, Social Security has become an economic time bomb ticking away within our society.

Inflation, unemployment and an unrelated combination of increasing benefits and shifting population patterns threaten its financial stability. The system is going broke. And the ever-increasing taxes needed to finance its inexorable growth are slowly undermining the job-creating capacity of employers, especially the nation's small businesses. As a result, the country is faced with angry taxpayers, anxious beneficiaries and long-term obligations on the U.S. Treasury that are staggering.

Clearly, constant tax increases, particularly payroll tax increases, are unacceptable. They retard employment growth and decrease the savings rate which is essential for investment and economic prosperity.

Small business in America is responsible for two-thirds of the jobs created in the United States over the past decade. But ever increasing F.I.C.A. taxes threaten its ability to perform this vital function.

Actually, there is no single Social Security program. There are in fact three distinct programs. The original and largest of the Social Security programs is the retirement program, or Old Age and Survivors Insurance (OASI). This program principally provides the elderly with retirement benefits and surviving dependents with survivors' benefits. In 1977, OASI took 75 cents of every Social Security tax dollar.

more----------

The newest Social Security program, added in 1965, is Hospital Insurance (HI) or Medicare - Part A. HI, as OASI, is focused on the elderly. It provides hospitalization insurance, and in 1977 took 15 cents out of every Social Security tax dollar. The third Social Security program is the one not focused on the elderly. It is public Disablility Insurance (DI). DI provides workers with insurance should they become disabled during their working years. In 1977, DI accounted for ten cents out of every Social Security tax dollar.

Each of these programs is financed from one source -- the employer/employee payroll tax. (The F.I.C.A. column on a worker's payroll check.) No other source is used. It should come as no surprise that the majority of small businesses pay more in payroll taxes than in any other kind of tax.

The actual transfer of funds from the taxpayer to the beneficiary is conducted on a "pay as you go" basis -- meaning that the taxes collected are immediately transferred to the beneficiary. In contrast to private insurance, the government does not invest an individual's social security retirement "contribution" (i.e. the taxes he pays).

In short, people now working pay for those now collecting benefits. And when the people now working begin to collect benefits, it is assumed the next generation will pay the bill. And therein lies the rub, because most experts agree that there won't be enough workers in the next generation to pay for the workers of this generation when the post World War II baby boom reaches retirement age early in the next century.

For example, the Center for Education and Research for Free Enterprise at Texas A&M University reports that 114 million U.S. workers and employers paid $99 billion into the Social Security fund in 1979, while 35 million recipients collected

more---------

$101 billion in benefits. This means that three people are paying into the system for every one receiving benefits. Shortly after the turn of the century, however, the ratio will drop to 2-to-1.

But what is to be done? Reduce benefits? Increase taxes again?

By 1977, it had become obvious that the Social Security taxes being collected were insufficient to cover the benefits being paid. The result was the largest tax increase in American history -- $277 billion over the ensuing ten years alone. From the 5.85 percent rate (for both the employer and the employee) and $16,500 wage base in 1977, the rate will rise to 7.15 percent (for both employer and employee) and the wage base to an estimated $42,600.

This tax increase was designed to keep the Social Security system fiscally sound well into the next century. But already there is a substantial and growing body of opinion that even more money will be needed in the years ahead.

This has not gone unnoticed. Perhaps for the first time in the history of the Social Security program, working people -- both those nearing retirement and those with many years still left in the workforce -- are genuinely concerned that in their time of need Social Security will let them down. That when their turn comes, there will be nothing left.

In a study for NFIB, released during the last week in May, the Houston opinion research organization, V. Lance Tarrance & Associates, found a number of disturbing trends.

For example, just three out of ten Americans -- a scant 31 percent -- feel the Social Security retirement income program is "working well," while twice that number, 63 percent, feel the program has problems.

Nearly two-thirds of the public (60%) feel the retirement income program should be "changed in basic ways," the study showed, while only 32% feel it should be "left as is."

more-------

Nearly seven out of ten Americans -- 68% according to the NFIB/Tarrance study -- recognize that the program is in financial trouble. Only 17% consider the Social Security program "financially sound," while another 14% are undecided.

It is important to note that the study was undertaken and results released well before the report of the Trustees of the Social Security Administration. The Tarrance study also disclosed that most Americans (81%) are counting on Social Security for some part of their retirement income, that confidence in the program shrinks significantly between age groups, and that two-thirds (67%) of the public are worried about their retirement income. Only 28% expressed confidence in the future and say they are "unconcerned."

Overall, the Tarrance analysis said, "the results indicate a serious lack of confidence in the retirement program ... across all segments of American society."

The study consisted of 1,500 interviews with voting-age adults conducted between April 2 and April 8, shortly before the Reagan Administration announced its plans to overhaul the Social Security System.

Just how bad is the problem? As a number of witnesses already have testified, the OASI fund could be in the red as early as next year. Yet, as bad as that would appear, the long-term prognosis is even worse.

According to Stanford University economist Dr. Michael Boskin when the post World War II baby boom generation reaches retirement age, around the year 2005, there will be an unfunded liability in the system of $600-800 billion (in 1977 dollars). Put in another way, the gap between Social Security's legislated benefits and the legislated taxes to pay those benefits is large enough to double the size of the National Debt.

more--------------

That doesn't mean Congress didn't tell the truth when it enacted the $227 billion Social Security tax increase in 1977. Congress said the increase would keep the system solvent into the next century. Despite current problems, its assessment was basically correct. But what got lost in all the discussion was the extent of the potential disaster which could occur just after the century's end 25 years from now.

Under current law, revenues and benefit payments (both of which increase) roughly parallel one another until the year 2005. At that time, people now age 40 will turn 65. The gap between revenues and benefits really begins here. It continues to grow for the next 45 years, directly impacting generations of Americans from approximately current age 57 to the yet unborn.

To be a little more precise: between the years 1980 and 2004, a surplus amounting to 1.4 percent of taxable payroll is expected. (Taxable payroll is just less than half the Gross National Product.) While that estimate will prove high, the situation degenerates in the following 25 years. The surplus becomes a deficit of 1.2 percent of taxable payroll. That is followed by a 25-year period of 4.6 percent deficit, bringing the total deficit to as much as three-quarters of a trillion dollars (in 1977 dollars).

Even facing this incredible gap, Dr. Boskin believes his estimate is probably optimistic. In order to make calculations such as this, certain assumptions about productivity, workforce participation, length of retirement, etc., are required. Dr. Boskin chose to use the intermediate assumptions of the Social Security Administration for comparative purposes (1977). Yet, some of those assumptions are debatable, and

more----->--

even a modest change would make an enormous difference in the gap.

One of the most critical of these assumptions is length of retirement. It involves the number of years the average beneficiary will collect benefits. Length of retirement is affected by a number of things: elderly life expectancy, number of people retiring early, and number of people retiring late. The Social Security Administration assumes only very modest increases in life expectancy. Yet, between 1960 and 1975, life expectancy for the elderly increased nearly two years. Early retirement also increased while late retirement decreased. Dr. Boskin estimates that a one-year change in the retirement period could affect the projected gap by $250 billion. Thus, if any factor (e.g., increased elderly life expectancy) or combination of factors serves to increase the retirement period by less than two years, the $600-800 billion gap increases to more than $1 trillion dollars (1977 constant dollars).

Obviously, the projected gap between legislated taxes and legislated benefits means the law will have to change. Taxes will have to rise more than now programmed, benefits will have to be reduced from projected levels, or some combination of the two will be required. If no benefit changes are made, it is estimated that total FICA taxes will reach 24 percent (12 percent for employers, 12 percent for employees). If no tax changes are made, retirement and survivor benefits must be severely curtailed.

Unfortunately, the projected gap between revenues and expenditures is not the only problem of the Old Age and Survivors program. Another one involves major inequities in the benefit structure. These inequities are of two types: those between people in the same generation and those between generations.

more---------

One of the most controversial and well-known inequities within a generation is the so-called earnings test. At age 65, individuals draw full retirement benefits. But if an individual chooses to supplement his or her income through work or earnings, he or she loses one dollar of Social Security for every two dollars earned after the first $5,000. In contrast, another individual with hundreds of thousands of dollars in pensions, interest dividends, capital gains, etc., would not have his or her Social Security reduced one penny. The difference is in how the income was obtained.

Another common inequity involves working spouses. At retirement, the worker receives a primary benefit. If he or she has a spouse, they will receive a second benefit amounting to 50 percent of the primary benefit. For example, Mr. or Mrs. A might have a primary benefit of $300 a month and be given a $150 a month spouse's benefit. The spouse's benefit, however, is given whether or not the spouse has paid into Social Security. It is therefore possible for one husband and wife combination to pay more in FICA taxes and receive a lower benefit than another husband and wife combination. These are just two examples of inequities within a generation. Many others exist.

Inequities between generations are less well known but probably more severe. Using current law, Dr. Boskin calculated how much people in each age group have paid (or will pay) into the Old Age and Survivors program over their lifetimes and how much their employers paid (or will pay). He then assigned interest to each year's payments and compounded it. Then he calculated the amount of benefits each age group will collect over a lifetime.

Persons age 65+, paid relatively little in Old Age and Survivors taxes over their lifetimes. Total taxes paid by succeeding generations become increasingly greater, however. In fact, the average family aged 25-34 will receive only one and a half times the benefits for 10 times the taxes as the average family age 65+.

more--------

There is something unique about the age group 25-34. It will be the first group under current law to receive a negative return (a "bad deal") on its Social Security tax dollar, but it won't be the last. The return for succeeding age groups will become progressively worse, Dr. Boskin finds.

Clearly, something must be done. But what? What steps need to be taken in order to solve this terrible dilemma?

Before outlining the major alternatives available, there are three points to remember: First, the government can't start the program all over again. It's not 1936. Congress must work with what it has. Second, the only methods to handle the long-term deficit are to raise taxes, lower benefits, or both. There is no magic escape; money doesn't grow on trees nor in a Social Security fund. Third, a healthy economy is absolutely essential. The higher the nation's growth rate, the more manageable our Social Security problem. But the opposite is true as well, and the nation's growth rate over the past several years has not been encouraging.

There is nothing particularly complicated about raising taxes to pay for legislated benefits. The only questions that need to be resolved are "Who will pay?" "How much?" "When and in what form?"

The most obvious variation of a tax increase is to simply raise FICA taxes in order to secure the amount needed to cover the projected deficit. If that variation were to be adopted, however, it is estimated that a 24 percent (12 percent for employers, 12 percent for employees) payroll tax would eventually be required. While the increase could be lower than 24 percent if large payroll-tax increases were to come sooner, this solution still would mean a hefty increase for both employers and employees -- increases that, quite honestly, neither the small business community nor the economy can afford.

more ---------

A more popular and widely discussed tax-increase alternative has been to fund a portion of the program through "general revenues." In other words, personal and corporate income taxes would be increased and substituted for a portion of FICA increases. Total dollars raised and expended would theoretically be the same whether FICA or general revenues were used. The major difference involves who picks up what portion of the bill.

Another variation of raising taxes would be to implement universal coverage. This solution would make everyone not now covered, principally civilian federal employees, participate in the system. The appealing aspects of this variation are that equity is created and that additional money is raised without increasing taxes for those presently in the system. But when people contribute, they receive benefits at some point. Thus, the major effect of bringing more people into Social Security is simply to make the total program (taxes and spending) grow.

Proposals to lower benefits are not as straightforward as those to raise taxes. No one, for example, proposes a straight five percent across-the-board benefit cut, although a number of proposals involve changing indexes or formulas on which benefit calculations are made. There is discussion of wage indexing, price indexing, replacement ratios, etc., terms generally alien to the public. However, their effect is to reduce the rate of increase in benefit expenditures.

Raising the retirement age is probably the most commonly discussed and recommended reform now under consideration. Dr. Boskin calculated that for each year the retirement age is increased, the long-term deficit falls by $250 billion.

The proposals noted above all address the projected gap, but none address unfairness to beneficiaries or the fact that some people are receiving more than they should on an actuarial basis. If some receive more, then others receive less. Suffice it to say that, as a rule, the young are the biggest losers and the younger they are the more they lose.

more----------

Fortunately, the financial and benefit-equity problems point to one common reform. It is the separation of the annuity and transfer functions of Social Security. It will simply be referred to here as "separation."

The idea of this plan is to provide Social Security annuities to retirees based totally on the amounts the individual and his or her employers contributed and on the interest earned. Benefit levels would not be affected by such things as the earnings test and the number of dependents. For example, if the average person at retirement had $60,000 in his or her Social Security annuity account and life expectancy was ten years beyond retirement, that person would draw a $6,000 per year ($500 per month) benefit. Social Security annuities would continue to be financed by FICA taxes. Nothing could be simpler or more equitable.

But there is good reason for social transfer benefits being paid to the elderly. Many of these people are poor and desperately need help. Therefore, if the Social Security system is to be made into a sound retirement program, by eliminating social transfers, something must be done about the substantial number of elderly poor. To ensure that the elderly poor do not suffer from elimination of Social Security transfer payments, a social transfer supplemental means-tested program would provide benefits to be paid from general revenues. Only the poor elderly would be eligible.

This is the thrust of Dr. Boskin's work and at the heart of what we call the NFIB Social Security Equity Reform Plan. The plan would accomplish two major objectives:

> 1) guarantee every working American a fair return, upon retirement, on all of the money he or she has paid into the system over the years, and 2) establish a fair mechanism for providing retirement benefits to those for whom the entitled annuity (and other income) would be insufficient to provide them with a decent standard of living.

more---------

The NFIB "equity plan" would, in effect, replace the current mixed retirement-income transfer program with properly separated -- and separately financed -- insurance and transfer programs. Taxpayers, upon retirement, would receive an actuarially fair annuity equal in principal amount to the sum of their historical wage taxes, the taxes paid on their wages by employers (and self employment taxes), plus interest. Under this Entitled Annuity Insurance program, retired people would receive exactly what they paid for. The program would be financed strictly by payroll taxes.

Elderly taxpayers and dependents of deceased taxpayers with inadequate resources also would be eligible for Supplemental Retirement Benefits, a separate but related program that would -- like any other income transfer program -- be funded by general revenues.

What would such a change do? Aren't proponents of this plan just shifting things around to be moving them around? If $1.33 trillion were taken away by eliminating social transfers and then given back, what good would be done?

Under current law, social transfers are paid to virtually every retiree whether needed or not. The retiree in his country home receives a social transfer just like the poverty stricken retiree. (When there is a cost of living increase, for example, every beneficiary receives it.) Both of these subsidies are effectively being paid by future generations, wealthy and poor who now must expect negative returns on their Social Security tax dollars.

In the separation proposal, social transfer payments to the non-poor are eliminated. The effect is a net cost reduction. Further, benefit equity is created. Everyone including the young, can expect a fair return on his or her Social Security tax dollar. If that return plus other income and assets proved insufficient, affected elderly would draw resources from a program specifically designed for that purpose. Finally, programmed increases in FICA taxes, a particularly severe tax for small business, could be somewhat reduced.

more-------

Clearly, none of the approaches available to the Congress will make everyone happy. What I would suggest, therefore, is that we look to other measuring sticks -- look for an approach that meets two important tests: that it is fair, and that it is economically sound.

The proposal we offer addresses the principal problems of Social Security. The plan would separate the insurance function and the social subsidy function of the Social Security system paying the former through payroll taxes and the latter from general revenues. (Historically all of our welfare programs have been funded through general revenues. It simply was never intended that welfare programs be funded through Social Security. There is no reason why the general public should not share in the cost of all welfare programs.)

The size of the insurance benefit would be based on an individual's (and his employer's) contributions. The size of the social subsidy would be based on need.

Thus, everyone paying into Social Security would be entitled by right to a benefit based entirely on the amount paid in and the years worked just like any real insurance program. If that amount plus all other income were insufficient (and for many it would be), then a subsidy based on need would be drawn. This subsidy would be paid from general revenues just like any other social program.

Today, young workers wonder whether they will receive retirement benefits. Those retired or soon to retire are nervous about the precarious financial state of the Social Security system. Changes must be made in the system and soon, or we will be confronted before too many years by a polarized society in which the young are pitted against the old, the taxpayer against the benefit recipient, the worker against the retired.

But if we act now to implement meaningful reform measures, we can restore to our Social Security system the public confidence and support it once enjoyed and still deserves.

In the weeks ahead, after actuarial studies are completed, the National Federation of Independent Business will offer its Social Security Equity Reform Plan to the Congress as suggested legislation. We hope we can count on you to give this proposal -- which is nothing short of revolutionary -- your careful consideration. We will look forward to working with you. Thank you.

Senator Armstrong. Finally, it is my pleasure to call a panel of authorities on a subject which has been previously discussed, and that's insurance.

Senator Moynihan and I have been discussing whether or not what we have here is life insurance, casualty insurance, social insurance, or welfare. So perhaps it is appropriate that the final panel consists of Mr. Donald A. Eichelberger, a CLU from Waterloo, Iowa. He is chairman of the committee on Federal law and legislation, and is accompanied by Mr. Robert A. Pierce, a CLU from Tigard, Oreg., who is chairman of the subcommittee on social security for the National Association for Life Underwriters; and Mr. Kenneth R. Austin, chairman and chief executive officer of the Equitable Life Insurance Co. of Iowa and a member of the American Council of Life Underwriters, accompanied by Mr. Arthur S. Fefferman, director of tax, pension and social security analysis, American Council of Life Insurance.

Gentlemen, we welcome you. We are looking forward to your testimony.

May I call first on Mr. Eichelberger?

STATEMENTS OF MR. DON A. EICHELBERGER, CLU, WATERLOO, IOWA, CHAIRMAN, COMMITTEE ON FEDERAL LAW AND LEGISLATION, ACCOMPANIED BY MR. ROBERT A. PIERCE, CLU, TIGARD, OREG., CHAIRMAN, SUBCOMMITTEE ON SOCIAL SECURITY, NATIONAL ASSOCIATION OF LIFE UNDERWRITERS

Mr. Eichelberger. Mr. Chairman, and members of the committee, my name Don Eichelberger. I want to thank Senator Grassley for his kind remarks at the beginning of this hearing. We are very proud of Senator Grassley in Iowa.

Senator Armstrong. We are very proud of him on this committee, too.

Mr. Eichelberger. Well, thank you.

Seated next to me is Robert A. Pierce, CLU, a life insurance agent from Tigard, Oreg. And Bob is chairman of our subcommittee on social security.

From the creation of the social security program to the present time, life insurance agents have been a primary source of information to individuals and families on what social security means to their financial future.

In their professional work, life underwriters counsel individuals and businesses on the means of providing financial security for themselves and employees through private life and health insurance. While it is probably safe to say that the Social Security Administration talks to more social security beneficiaries than anyone else, I think it is also accurate to say that life underwriters talk to more social security taxpayers than anyone else.

Taxpayer views and apprehensions are going to be reflected in our comments today.

To share some of our ideas for the short- and long-range changes, I would like to call upon our subcommittee chairman on social security, Robert A. Pierce. Bob.

Mr. Pierce. Senator Armstrong, Senator Moynihan, and members of the committee, we appreciate the opportunity to speak before you today. We would appreciate if our written testimony could be made part of the record, and we will summarize other information.

Senator ARMSTRONG. Your testimony, of course, will be included in the record. We are grateful to have it.

Mr. PIERCE. Thank you.

In your opening statement this morning, Senator Armstrong, you made a statement about the fact that we were talking about people. Of all the groups that have testified today, our organization—the National Association of Life Underwriters, with 140,000 life insurance people who work out people-to-people—we see our clients in their homes, in the business, we talk to them on the phone—I feel that there is no one else that speaks regarding social security with as many taxpayers and probably with as many beneficiaries as our members.

Something which comes back to us on a regular basis, and I am seeing it in my little hometown on a regular basis every day, is the tremendous concern by people about social security.

Now, the concern very seldom focuses on what the amount of benefit is. Interestingly enough, for most people it doesn't matter whether they are 25, 40 or 60 or 70, they seem surprised at how generous the benefits are.

Their concern is one of continuity. One of survival. One of will their dollars be there.

I know that that's different than a lot of the statements that I have heard sitting here today, but that's what we find out in the public.

Now I would like for you to imagine my graph, if you could.

My graph is a plain piece of paper with a line starting at the upper left-hand corner that goes directly toward the lower right-hand corner.

My graph shows the citizen confidence level of social security.

Now if we look over a period of time, I believe that it is very understandable why citizens' confidence in social security has been diminished.

A statement was made earlier that as long as there could be majority of votes in Congress, social security would not die.

I disagree with that. As long as taxpayers are willing to pay taxes, social security will not die.

Looking at last year, for example, Congress experienced tremendous internal strife as to whether to allow the social security payroll tax increase to occur that was on the books that would go into effect January 1, 1981—and it did go into effect. That was a very minimal tax increase compared to the numbers we see here.

[Senators Armstrong and Moynihan present.]

Mr. PIERCE. If the current workers are very concerned about where the payroll tax level is today, how can my children, my grandchildren, and my great grandchildren be expected to feel any different than we as workers do today?

How can we burden them with the kind of numbers we see here?

I see that as the long-term crisis, or whatever word we are going to use. We would be happy to address other problems along the way and share our observations on how to solve them.

But, the crisis is the payroll tax in the future which cannot be supported by our future populations if those are the numbers.

I wouldn't ask my children or your children to support them.

I would like to take a few moments to address some long- and short-range considerations that National Association of Life Underwriters have examined. Your committee has already addressed the minimum benefit problem by reducing opportunities for certain segments of the population to take advantage of the disproportionate benefits which result from short-term labor under social security; and the adult student benefits which we feel can be covered through other arrangements on a needs-tested basis.

Other areas that we feel should be addressed in the short term are the CPI increases. We feel that it is inappropriate to tie a benefit to one level and to tie a revenue to a separate level. Seldom will they run in tandem, as has been the case expansion for the past few years where benefits have outrun the revenues.

Consequently, we recommend that a price index or wage index, whichever is lower, should be used to control the increase for the year.

On the subject of medicare and general revenue financing, we are adamently opposed to any general revenue financing. That is not a solution to the problem. That is only a method of helping to transfer some tax dollars from another source.

While loans are presumed to be temporary, that hasn't happened before. That would be a permanent problem from there on.

Right now one thing that I do not find among my clientele which involves businessmen and individuals—they don't want those taxes paid by anybody else, they just want a reasonable balance between what they are paying and what they are going to have later.

Interfund borrowing is again just a temporary place in the weather to solve a very temporary thing. As we heard, I think it would only extend the problem by 10 months, so we would have to face it again.

Under our long-range solutions, universal coverage, while we have heard considerable testimony, we feel that the information is substantial in favor of universal coverage. It is not a new subject. For nearly 40 years there have been recommendations; and, every group that has been asked to study that issue now by Congress has come back with a recommendation that universal coverage be adopted.

One important thing that universal coverage will provide is confidence by the public. The confidence that Washington and the Government employees are participating in the same plan, so consequently it will live instead of being threatened with death.

We recommend an increase in the retirement age. This is certainly a sensible thing. It has been recommended again by all studies, but primarily as workers live longer and enjoy better health, it's a reasonable way to balance the system.

Lowering of replacement ratios. Over the past several years replacement ratios have increased about 30 percent over what the historic levels have been and many experts today feel that they should slowly be brought back in line.

We have a concern with one particular area in the administration's proposal, that being the elimination of the work clause which has been discussed here considerably today. It seems that a time that long-range cost control in the system is so necessary it is inappropriate to put in such an item at the same time.

In this particular area, the work clause helps to identify those who are not able to work because of disability or old age, or their choice. It does separate those who are continuing to work from the actual retirees.

Again, we speak with your constituents, and our clients, on a regular basis. Many of them lack confidence that Congress will be able to solve the problems. When I speak of my chart, that line is getting near the bottom of confidence level. If somehow members of the committee could sit in my office in Tigard, Oreg., for 1 day, I guarantee you there are at least five people a day that express concerns—either on the phone or face-to-face over that problem.

I ask your committee to take the very hard route that is here. You have many good ideas to choose from, but the American public needs your confidence and your decision to help the system survive.

We thank you for your time.

Senator Armstrong. Thank you, Mr. Pierce. That's a good statement. I don't know whether to be pleased or sorry that the Senator from Louisiana wasn't here to hear what you just said because when I made a somewhat similar observation, although not with the elloquence that you just have, he found it somewhat amusing.

I think you have really identified a serious problem, all the declarations in the world—that "nothing can happen, Congress will always bail the system out some way"—are not going to build confidence. The confidence will be built by solid action rather than simply promises.

I appreciate very much your statement.

Next, let's hear from Mr. Kenneth Austin from the Equitable Life Insurance Co. of Iowa.

STATEMENT OF MR. KENNETH R. AUSTIN, CHAIRMAN AND CHIEF EXECUTIVE OFFICER OF THE EQUITABLE LIFE INSURANCE COMPANY OF IOWA, AND CHAIRMAN OF THE COMMITTEE ON SOCIAL SECURITY OF THE AMERICAN COUNCIL OF LIFE INSURANCE, ACCOMPANIED BY MR. ARTHUR S. FEFFERMAN, DIRECTOR OF TAX, PENSION AND SOCIAL SECURITY ANALYSIS, AMERICAN COUNCIL OF LIFE INSURANCE

Mr. Austin. Thank you, Mr. Chairman. I am delighted to be here. I am the chief executive officer of the Equitable Life Insurance Co. of Iowa and I am chairman of the Social Security Committee of the American Council of Life Insurance. I might note, just for the record, that by pure coincidence Mr. Eichelberger is a leading representative of the company I head. But we come here from two completely different organizations. And, as is true on your side of the table, colleagues sometime disagree slightly.

With me today here is Mr. Fefferman from the council staff, and we are appearing on behalf of the council which represents 518 life insurance companies, acounting for 95 percent of the life insurance in force in our country and some 97 percent of the life insurance assets.

We have a more detailed statement which we have asked to be filed in the record.

We urge you to take prompt action to place social security on a sound financial basis. In view of social security's vital importance to the older people of our Nation, we simply cannot afford to risk weakening the system by continuing expenditure patterns that substantially outrun receipts. Nor can we afford to decide what needs to be done on the basis of best case assumptions or anything approaching best case assumptions.

We recommend the following specific actions. Social security payroll taxes should be set at levels which are adequate to finance reasonable benefits provided by law. The use of general revenues to finance social security should be avoided.

In a very real sense, there is no general revenue available to finance social security in view of the large budget deficits confronting us.

Furthermore, general revuenue financing would reduce confidence further in the social security and would be widely construed as a sign that we are not willing to face up to the hard issues involved in placing the system on a sound financial basis.

Next, we believe that present procedures for indexing social security benefits should be revised to keep the costs within the Nation's fiscal capacity. One possibility would be limit the annual increase in benefits under indexing to a specified percentage of the CPI.

Another possiblity would be to limit the annual increase in benefits to the increase in the average wages for years when wage increases are less then the CPI.

The present Consumer Price Index should be reviewed to determine whether it overstates increases in certain living costs such as housing. We support the administration's proposal to moderate the increases in initial retirement benefits for active workers by adjusting the bend points on the weighted benefit formula by 50 percent of the increase in average wages for 1982 to 1987.

We also endorse the administration's proposal to place the automatic increases in benefits on a fiscal year basis by deferring the data of such increases from June to September.

Provision should be made now for a gradual increase in the retirement age under social security after giving individuals substantial advance notice to adjust their retirement plans.

We suggest that starting at about the year 2000 or sometime before that, the normal retirement age be increased one-fourth of a year annually until age 68 is reached in the year 2012 then, or later years.

At the same time, the early retirement age at which reduced social security benefits are available, would be increased to 65 with corresponding gradual increments. Or 62 could be kept as the earliest retirement age with an actuarial adjustment in the benefit.

We support the administration's proposal to encourage later retirement under social security by changing the benefit computation point from age 62 to age 65 and by eliminating children's benefits for retired workers age 62 to 64 provided there is advanced notice to give individuals time to adjust their retirement plans.

The retirement test, which reduces social security benefits for individuals earned over specified amounts of income should be retained.

Elimination of this test would result in the payment of benefits to individuals who do not need them as a replacement of earnings and would increase social security expenditures at a time when we should be considering every possible means of reducing them.

Mr. Chairman, if I may add a note. As I have listened to you with great interest today, your inclination to eliminate the retirement test is about the one point on which I have disagreed with your statement.

Let me suggest the reason.

If, in fact, this were an insurance system and people had paid for the benefit, I would agree that we should eliminate the retirement test.

The fact is that someone who retired January 1st of this year, after having paid full amount of social security up to that time, would get back his payment in about 17 months.

Thus, our concern with eliminating the retirement test is we would be paying benefits to people who are working and don't need them when we can't afford it.

Next, windfall elements in the social security benefits should be eliminated for former Government employees and employees of nonprofit institutions who have spent most of their working careers in noncovered employment. Eventual universal coverage under social security should be provided for all Government workers and employees of nonprofit organizations in a fair manner.

I have not heard nonprofit organizations mentioned here very much today.

I want to suggest also that the option of various groups, State and local governments and nonprofit institutions, to withdraw from social security should be eliminated, after a short grace period during which the filing of notices of intent to withdraw might be permitted.

The family maximum cap now applicable to disability should be extended to retirement and survivor situations as proposed by the administration.

The administration's proposals to prevent excessive disability insurance benefits and to relate such benefits more closely to the individual's work history and medical condition should be adopted.

Finally, pressures for placing increased financial burdens on social security should be reduced by maintaining a favorable environment for growth of voluntary pension plans and other private savings for retirement. Raising the tax-deductible limits for contributions to IRA's and H.R. 10 plans and allowing employees in covered pension plans to participate in IRA's and deduct contributions to pension plans within the IRA limits would reduce demands for a costly expansion of social security benefits and help provide capital formation that is so essential for dynamic growth of our economy.

We appreciate, again, this opportunity to appear.

And, thank you for letting us be here.

Senator **ARMSTRONG**. Thank you very much, Mr. Austin.

Mr. Fefferman, are you——

Mr. **FEFFERMAN**. No, Mr. Chairman, this covers my statement.

Senator ARMSTRONG. I wasn't sure whether you had a separate statement to make or whether you were here to just keep an eye on these other witnesses.

Mr. FEFFERMAN. Thank you, Mr. Chairman.

Senator ARMSTRONG. Well, I am very grateful for this testimony. And, by the way, Mr. Austin, I think there is merit in the point that you made in disagreement with my observation earlier.

It bears in part on the issue which NFIB has raised previously as to whether or not we ought to split out the annuity aspect of the retirement fund from what they have characterized at least as the welfare part of the fund. It goes somewhat to the concept of what you think we have—whether it is really social insurance or life insurance or casualty insurance. I understand your point, even though I am not completely in agreement with it.

Mr. AUSTIN. It isn't really any of those things. It is a transfer system. It does create an entitlement sort of situation.

Senator ARMSTRONG. Well, I only listed 3 of the descriptions that have been applied to it.

The Senator from Idaho thinks it is a chain letter, and there are others, responsible people, who really think it is a Ponzi scheme. Maybe that's the place I should start with my questions of you gentlemen.

Not to ask you whether or not you think it's a Ponzi scheme or a chain letter, but to ask you this—if we drew a line today, and this is a question my constituents ask me all the time, and said anybody who wants to opt out of the system—I do not advocate that, let me make it clear—but if we said we are going to allow anybody who wants to take the same amount of money and put it into private insurance, would they get a better deal by and large than they are going to get out of retiring under social security, or a worse deal, or about the same?

Mr. AUSTIN. Well, Senator, you answered a part of that question very well this morning by saying that the problem is that we have here a $5 or $6 trillion deficit. A deficit in terms of a pension plan which has to be financed. So there is really no particular relationship.

Senator ARMSTRONG. If we did not have that though. Starting today, if we, as if my magic, provided for the retirement of those who have already retired, thereby eliminating that unfunded liability, what would happen if we took the same amount of money that would be taxed on payroll and invested it in some kind of private insurance program? Would they do better, or not as well?

Mr. AUSTIN. Well, of course, we are somewhat prejudiced. We think that private industry can probably do better.

But the fact of the matter is if you are dealing with the same dollars paid in, the same benefit schedule, the same mortality tables, the same investments, and so on, presumably the benefits would be comparable. In other words, there is nothing magic about one side or the other administering the fund.

Senator ARMSTRONG. Yes, sir.

Mr. PIERCE. Senator Armstrong, the fallacy of trying to answer that question is that you can't draw a simple scenario. Based upon inflation, based upon the fact that social security has the ability to collect costs, premium, however you want to call it on the basis of its right to tax the citizens, they are really two different types of programs.

While literally hundreds of people have asked me why can't you guys work to get something that we can just pull out and do on our own, you and I both know that before they had social security, most people didn't do their own. And social security fills a very important role in that regard.

I believe the reason that you find so many people spending so much of their time here helping with hearings is because of the import we see in maintaining something that has been established that's a fundamental part of the security program for our country.

When you look ahead, and you see the potential, it is the same thing as if I, or Mr. Eichelberger are dealing with a client and we see something in their future that isn't properly prepared for, we develop alternatives for them to look at to solve that. That's exactly what we are asking the Congress of the United States to do here—we see something that's a severe concern to us, and there is time to keep it in line.

But we can't, as one statement was made today, we can't wait until the year 2020 and then say folks, the pessimistic curve really worked, now what are we going to do, because there is no fund, there is no source to go, there is no general revenue that is accumulating in a sinking fund to help bail us out then.

Senator ARMSTRONG. In other words, you really think from a judiciary standpoint, we can't take even our best guess. We have to take a less optimistic viewpoint in order to provide a margin of safety.

Mr. PIERCE. This country put a man on the Moon. If you worked with NASA, you would find that they didn't just shoot the rocket out there in space someplace and then say oops we missed. That's about what's happening here.

Instead they have course corrections all along the way after some very judicious planning at the start. That's exactly what these curves do—is they indicate that over the past we have historically somehow missed the mark in the economic assumption we used. Now, the reserve has gotten down to where we only have less than 2 months' reserve in the trust fund. When there was a 1½-year reserve, you could be a little sloppy. You can't be sloppy now, because there's no place to pick that up as soon as the trust funds are dry.

So we have to make course corrections along the way. And we have to make a major correction so that the errors we see out there in the future can be corrected.

Senator ARMSTRONG. Do you have on the tip of your tongue when there was a 1½-year reserve in the trust fund?

Mr. PIERCE. I don't know how long ago.

Senator MOYNIHAN. Up to 1960.

Senator ARMSTRONG. I am thinking of the early sixties.

I am advised by staff that as recently as 1970 there was more than a year's. You make a good point.

I want to ask one additional question that, in a sense, is a matter within your expertise uniquely.

If we make changes in the long-term structure in benefits of social security, how does it bear on your industry in terms of whether those changes are made drastically or phased in. Does that have any particular effect on the insurance industry?

Mr. **Austin**. Well, I would like to say that several witnesses here have very properly talked about people counting on social security, relying on social security. We in the life insurance industry rely on social security, too. For 50 years we have been selling pension plans to clients, which were supposed to be supplementary to social security. We preached the idea of social security as a floor of protection and then we, with our pension plans or with private savings supplement social security.

Senator **Armstrong**. So you weigh in on behalf of gradual rather than abrupt change?

Mr. **Austin**. Yes, are very definitely. Not only from a humane standpoint, but also from the standpoint of our own business, we recommend gradual changes.

In no place in our suggestions have we recommended any reduction in present benefits. I have heard a lot of people talking today about cutting, or slashing benefits; we are only talking about slowing increases to the level we can afford.

Senator **Armstrong**. Thank you, that's a point that we must everylastingly make.

Yes, sir, I will take your observation and then Senator Moynihan, I think has something to relate.

Mr. **Pierce**. From the sales point of view, in other words from the point of eyeball-to-eyeball contact with our clients, I think the important thing is that people regain confidence in social security.

I had a client call me this week—female, just turned age 63, she's a widow, she's a cafeteria manager in a grade school. She said, Mr. Pierce, I have got to retire this year. I said well, why is that? She said they are cutting my benefits for early retirement, and if I wait till 65, I'll have to wait till 68. I said, well, wait a minute, you are 63. And she said from everything I have seen in the newspaper, she says there are several people who have told me I have got to retire. Well, as I told her, certainly because of our contacts, that's not the case.

But I think that such emotionalism is a growing scenario that we see now, that people feel they are standing on quicksand. And, as long as we have a program that's going in the right direction, you'll find that 140,000 members of our association who have been supportive, will continue to be extremely supportive of social security because it is part and parcel of our presentations, our descriptions and the service we do for clients. But we have got to have some confidence that it's going to be there ourselves.

Senator **Armstrong**. Thank you.

Senator Moynihan.

Senator **Moynihan**. Mr. Chairman, I would just like to thank, these gentlemen for their testimony and for telling us what, as you said, we have to know. This has to be a predictable system that can change. But it can change over time horizons that are not jolting and not threatening. We have had a lot of emotionalism for a while, but I think it's over.

I would like to say that I think the administration made a mistake in its May 12 proposal—as much because its changes were too abrupt as anything else. Altogether too abrupt or much too abrupt. You have your views, but no one would say that's the way to change the system. We're not going to change it that way.

We are going to try to do a decent job in this committee. A responsible job. We know we have two problems—a very near-term one and a long-term one.

I know that we are going to have a good outcome because the chairman is the chairman to do that. He has put up with me for a lot this week, and I have been waving my arms and saying awful things about his charts, and making charts of my own.

I even have here a definition of crisis from the "Oxford English Dictionary." [Laughter.]

Senator ARMSTRONG. Oh dear.

Senator MOYNIHAN. It says "time of danger or suspense in politics, commerce, et cetera".

Senator ARMSTRONG. That's what this is.

Senator MOYNIHAN. I would like to thank you, Mr. Chairman. I think we have had good hearings, with many very thoughtful comments that we have had here, many suggestions. We have a responsibility to the social contract. Lots of plans all over the country are based, future planning is based on this beginning.

We'll be responsible I assure you. I just want to thank the chairman again for the courtesy that he has shown those of us over here who every so often are a bit difficult.

Senator, the majority leader remarked in private—I don't mind saying it in public—he said that we are finding that it is easier to throw hand grenades than it is to catch them. [Laughter.]

Senator ARMSTRONG. That was an interesting observation by the majority leader. What I want to know is what prompted him to say that to you?

Well, I thank the panel too. I just want to respond in kind to Senator Moynihan.

I am grateful for your expertise. Obviously this is a matter that concerns you greatly, and about which you know a great deal. I look forward to working out a solution.

I do want to close where we began with the question of whether or not the system is in crisis. I think it is, even by the "Oxford English Dictionary." I don't think it is a calamity in the sense that I don't think it's irretrievable or a problem that we are incapable of solving.

I do think we are in a moment of political suspense, to quote the Oxford dictionary.

I think we are in a moment of decision. Literally at a moment in which we shall decide whether things will get better or get worse.

You also mentioned in referring to the HHS news release, which I had honestly not seen until you referred to it, you questioned the use of the term bankrupt. I did consult "Webster's New World Dictionary" to find out what it means to be bankrupt, because since that was a term that obviously offended some—although not me particularly. As I did not attach any emotional significance to it. I assumed that it means, loosely, anyone unable to pay his debts.

Well, that's exactly where the social security system is going to be next year, if we let it happen. But we're not going to, are we?

Thank you, panelists; thank you, staff.

[Statements follow:]

NALU The National Association of Life Underwriters
1922 F STREET, N.W., WASHINGTON, D.C. 20006 • 202 / 331-6000

STATEMENT
WITH SUMMARY OF PRINCIPAL POINTS

ON

SOCIAL SECURITY FINANCING AND OPTIONS
FOR THE FUTURE

TO THE

SOCIAL SECURITY SUBCOMMITTEE
OF THE
SENATE FINANCE COMMITTEE

BY

DON A. EICHELBERGER, CLU

AND

ROBERT A. PIERCE, CLU

JULY 10, 1981

Summary of Principal Points In
Statement of the National Association of Life Underwriters

1. The financial dilemma of Social Security can in a large part be attributed to prior overexpansion. To insure that the system's original purposes continue to be served certain programs must be pared down or eliminated.

SHORT RANGE PROPOSALS

2. The abolition of the minimum benefit and payments to students over 18 who continue their education is necessary. The real purpose of these programs can be better accommodated elsewhere.

3. The Consumer Price Index is seriously distorted when applied to Social Security beneficiaries. Benefits should rise with a revised Consumer Price Index or with the increase in average wages, whichever is lower.

4. Medicare should not be funded in whole or in part by general revenue. Such a fundamental need must not be subjected to budgetary football.

5. Interfund borrowing would add to the problem, not provide a solution. A permanent restructuring of the tax rate would build public confidence.

LONG RANGE PROPOSALS

6. Social Security must be extended to cover federal, state and local government workers. In addition to treating everyone equally it will alleviate public resentment of the windfall benefits phenomenon.

7. The full retirement age should be increased to 68.

8. An across the board lowering of replacement ratios should be instituted.

9. If, after making all the changes recommended above revenues are still inadequate to carry the system, the tax rate should be increased. The wage base should not be increased. It was never intended as the revenue raising mechanism of the system.

INTRODUCTION: Mr. Chairman and members of the Committee, my name is Don A. Eichelberger, CLU. I am a practicing life insurance agent from Waterloo, Iowa. Seated next to me is Robert A. Pierce, CLU, a life insurance agent from Tigard, Oregon. We are appearing here today as representatives of the National Association of Life Underwriters (NALU). NALU appreciates the opportunity to present its views on ways to preserve and strengthen the Old-Age, Survivors and Disability (OASI) System.

The National Association of Life Underwriters is a federation of approximately 1000 state and local associations which in turn have a combined individual membership of over 140,000 life and health insurance agents, general agents, and managers doing business in virtually every community in the United States. The individual members of the federation are called life underwriters. From the creation of the Social Security Program to the present time, life insurance agents have provided a primary source of information to individuals and families on what Social Security means to their financial security.

In their professional work, life underwriters counsel individuals and businesses on the means of providing financial security for themselves and employees through private life and health insurance. While it is probably safe to say that the Social Security Administration talks to more Social Security beneficiaries than anyone else, it may also be accurate to say that life underwriters talk to more Social Security taxpayers that anyone else. Taxpayer views and apprehensions over the status of Social Security are reflected in NALU's comments, today.

The kinds and amounts of insurance to be sold frequently are determined in part by the benefits provided by Social Security. Thus, Social Security plays a significant role in the financial security of most individuals. And it is high on their list of concerns.

Because of their daily encounter with Social Security life underwriters have developed expertise in the area. Lately, apprehension has crept into the minds of life underwriters who may view a Social Security system allowed to grow too large as a source of unwarranted competition. Then, too, life underwriters are well aware of Social Security's growing financial problems and burdens. Overall, however, life underwriters have been supportive of Social Security over the years and continue in that posture today.

THE NATURE OF THE CURRENT DILEMMA: As originally conceived and designed, the Social Security program is socially and economically desirable; but it is essential that the program be soundly maintained. Overexpansion of the program must be avoided, since such overexpansion would substantially increase the tremendous financial burden already facing present and future Social Security taxpayers, and poses a threat to the safety and continued existence of the program itself. Unfortunately, today's leaders are presented with painful choices because their predecessors ignored this principle.

The Administration projects, under pessimistic economic assumptions, that the deficit of the Social Security program will be $111 billion by 1986, and bankruptcy in 1982 if nothing is done to shore-up the program. The time for congressional action to bring the system back to financial stability is now.

The nature of the short-term financial problems besetting Social Security and the prospects for even more severe problems in the future have been ably explored and documented by the various experts who have already appeared before this distinguished Subcommittee. It is not our purpose to go over this ground again and we will not attempt to do so here. In the balance of this statement, NALU will present its ideas on how these short and long-term problems might be solved.

SHORT-RANGE PROPOSALS

STUDENT AND MINIMUM BENEFITS: NALU views with great interest President Reagan's proposals to abolish the minimum benefit and payments to students over 18 who decide to continue their education. We believe that priority lines must be drawn. The basic needs addressed by Social Security at its inception were food, shelter and medical care which must continue to be served. The abolition of the minimum benefit and student payments would seem to be in line with Social Security's original intention.

The needs of persons who receive payments under these programs would be better accommodated by other appropriate federal assistance programs. For example, those truly dependent on the minimum benefit would probably qualify for Supplemental Security Income and students could draw upon federal and state grant and loan programs.

CONSUMER PRICE INDEXING: Distortions in Social Security's automatic cost of living adjustment mechanism must be cured. Government and private sector economists now agree that the Consumer Price Index is seriously distorted when applied to Social Security beneficiaries, particularly those on retirement. Runaway inflation in new housing, mortgage rates and energy do not impact as heavily on Social Security recipients as they do on the general working population.

Experts have already testified before this Committee that the 100% cost of living adjustment overstates the actual rate of inflation and overstates the true cost of housing to individuals.

Changes in the CPI factor need to be coupled with another change in the automatic cost of living mechanism in order to prevent future economic conditions from running away with future costs. Presently, there is no tie between the cost of living mechanism and the underlying financing structure based on wages and income from self-employment. But as economic forecasters have pointed out, the current cash flow problems of the OASI trust fund are being precipitated by two factors in tandem. Inflation is higher than expected, so benefits are automatically adjusted higher than expected. At the same time lower than expected employment and increases in wages have slowed contributions to Social Security. These two factors work together to cause the problem. Therefore, they should work together to solve it.

BENEFITS SHOULD RISE WITH THE CONSUMER PRICE INDEX, OR WAGE BASE, WHICHEVER IS LOWER: In the future, the system should be geared so that benefits can only be paid to the extent that increases in wages occur, presuming the Congress wishes to maintain the Social Security program on essentially a pay as you go system. No insurance system, public or private, can maintain its integrity without the ability to control income and outgo of the system. Steps must be taken now to tie the benefit structure to its underlying financing structure so that the two may go forward together.

GENERAL REVENUE FINANCING FOR MEDICARE: NALU opposes strongly the financing of the Social Security system through direct contributions from general revenues.

NALU is opposed to general revenue financing, even on the somewhat limited basis to fund hospital insurance. We believe that the program will be irreparably harmed by general revenue financing. In the short run general revenue contributions may provide relief from anxiety about the financial stability of Social Security, but we believe that such relief will be short lived.

The Social Security tax remains the best means to keep the Health Insurance Fund intact. If Medicare were to have to fight with MX missiles, for example, it might lose out. Such a spectacle would, in our view, be unconscionable.

Our experience has been that the tax paying public sees a direct correlation between general revenue financing and the creation of a needs test for the receipt of benefits. Tax paying Americans view their tax contributions as premiums which purchase future benefits. Though technically not correct, the public believes Social Security benefits are an earned right. General revenue financing is likely to be the last straw as far as public confidence is concerned. Without widespread worker support, we believe the system would be imperiled.

INTERFUND BORROWING/RATE REALLOCATION: As pointed out by the Administration, Congressional Budget Office, and other concerned groups, the OASI Trust Fund will experience severe cash flow inadequacies in the very near future and must stop paying benefits unless action is taken. Obviously, the specter of a depleted OASI Trust Fund is viewed with great alarm by individuals currently on, or soon to be on, the retirement rolls. Bad news travels quickly when someone's financial security is at stake. It should come as no suprise that the retired population is seriously concerned about its benefits.

The tax paying public, however, is just as concerned. Ever more frequently, life underwriters hear this general concern expressed by relatively young workers who ask whether there will be any Social Security benefits at all for them when they retire. Public confidence in the system, in our opinion, is eroding quickly and once lost will be difficult to recapture.

Interfund borrowing would, in our view, only exacerbate these concerns. Interfund borrowing is widely perceived as a first step toward general revenue financing. Last year Congress legislated a reallocation of the tax rate. If further steps need be taken to redistribute the funds flowing into the Social Security System, a permanent restructuring of the tax rate should be undertaken again.

The discipline necessary to implement a rate restructuring can provide the basis for real improvement in public attitude towards Social Security. News of the oversight function will reaffirm the notion that a responsible Congress is making judgments that will guarantee the continuation of the Social Security System into the twenty-first century. While a restructuring of the tax rate is less flexible than a simple interfund borrowing proposal, there is a certain comfort in a permanent solution.

LONG RANGE PROPOSALS

UNIVERSAL SOCIAL SECURITY COVERAGE: It is a basic

NALU policy that Social Security be extended to cover the entire working population. Therefore, we endorse in general the concept of universal Social Security coverage.

We support universal Social Security with some reservations, however. First, individuals who have already retired without having been covered by Social Security should not have benefits reduced. Second, once extended to all workers, newly covered workers should not have their combined benefits lowered. Third, employee contributions under the new system should be no higher in the aggregate than the worker is now paying, at least for a transitory period. Depending on what benefits are wanted in the future, however, contribution rates may have to go up or down.

REASONS FOR SUPPORTING UNIVERSAL COVERAGE: On balance, NALU believes that universal Social Security coverage would have salutory benefits. These may be summarized as follows:

1. Psychological. The lack of coverage of a large group of individuals, principally federal, state and local government workers, is creating a significant morale problem. There is a growing resentment among the general population about sizable increases in the Social Security tax rates and wage base. This resentment is heightened because people in the private sector know that there are many individuals, chiefly government workers, who do not share in the experience. Universal coverage would lessen this resentment and foster an attitude of unity.

Coverage of federal government workers in particular may bring a new perspective to Social Security by the people who run it. It is inconceivable to NALU that the individuals who make the decisions on Social Security, namely Members of Congress and employees of the federal government, are not themselves covered by the system. Instead, they are covered by what is generally regarded as a rather plush retirement system. Many people do not believe it is possible for Members of Congress and civil servants to make the best decisions possible about Social Security when they themselves have no stake in it. We agree.

2. Eliminate Windfall benefits. One of the most disturbing aspects of Social Security today is the ability of some workers to take advantage of the minimum benefit provision. The minimum benefit provision was adopted by the Congress to help individuals who work at low wages for a long period of time. As adopted, this provision has a worthwhile goal, but many workers who are not low paid have become its beneciary.

This occurs when a worker not covered by Social Security either moonlights or retires from government service at a relatively young age, goes to work in covered work, and becomes eligible for the minimum Social Security benefit, a benefit much higher than that which would be purchased on an actuarial basis by his contribution.

There seems to be widespread relief that government workers in particular have placed themselves in a superior position vis-à-vis the private sector. There is widespread belief that government workers enjoy pension programs that far exceed those that are available to the private sector, and have manipulated the Social Security system so as to take advantage of the minimum benefit law. Lifelong coverage under Social Security would put an end to all windfall benefits problems, and should be adopted for that reason.

3. Floor of Protection. For our mobile work forces, universal coverage would guarantee that a basic floor of protection would be placed under the entire work force. Individuals moving in and out of covered work may lose some or all Social Security benefits by doing so. These benefits may not be made up elsewhere.

All workers should be guaranteed a basic minimum floor of protection even if they move from job to job. This security is available to most private sector workers now and should be made available to the entire work force.

4. Equalize Social Insurance Aspect of Social Security. The weighted benefit formula built into Social Security benefits provides that a worker with a lower average income receives a higher proportion of that income in benefits than does a higher paid person. Higher paid persons pay for the weighted benefits through lower replacement ratios. This welfare aspect of Social Security is not shared by workers not covered by Social Security.

RETIREMENT AGE: Several alternatives to the current full retirement age and the early retirement age have been recommended by individuals and groups. The most often mentioned is age 68 for full retirement and age 65 for early retirement. NALU believes that there is no inherently correct age, but ages 68 and 65 respectively for the following reasons seem about right.

Life expectancy is increasing. While this is good news personally, it is bad news financially. Benefits must be paid longer, thereby increasing the burden on the system.

Today our older citizens are more vigorous and are leading more productive lives and a significant number could work longer if required. NALU believes that this need should be addressed now. While we would prefer to immediately implement age changes, prudence dictates it be phased in over a relatively long period of time starting in the future.

REPLACEMENT RATIOS: Even after increasing the age of retirement, one more painful step is likely to be necessary. NALU believes that an across-the-board lowering of replacement ratios should also be instituted. Difficult as this may be, it is necessary in order to return the system to its proper position as the basic floor protection. The private sector can then build on a more solid, though admittedly smaller Social Security base.

TAX RATE VS. WAGE BASE: If after implementation of the changes we have outlined there remains a deficit, it should be financed with a tax rate increase, not a wage base increase. Our objection to financing benefits via the wage base rests on the precept that the tax base was never intended to be the revenue raising mechanism for the system; neither is it a very efficient means of doing so. Rather, the wage base was intended to delimit the extent of benefits to those workers within the system. And, over the years, the equalization of the wage base between employers and employees was intended to underscore the principle that employers and employees are both responsible to the same extent for the financing of the system.

An increase in the wage base would have a deleterious effect on the private sector. The higher the wage base goes, the higher the benefits and taxes go, and the less net income remains for private investment or savings as employers and employees see fit. The insurance industry, securities, banking and thrift markets would all be adversely affected, as each represents a traditional place where workers can save for their own financial security. Increasing the wage base means increasing the number of people who will leave more of their income with the government and have less of it for their own use. This loss of discretion on the part of workers has an immediate impact on such private sector investments as insurance, but we believe that it has a long-term effect on the ability of people to make judgments about their lives.

SUMMARY: Mr. Chairman and Members of the Subcommittee, NALU shares your deep concern over the future of the Social Security System. These hearings are a tribute to your commitment that its noble purpose continue to be served. We urge you to act expeditiously to:

1) Eliminate the minimum benefit;
2) Phase out adult student payments;
3) Restructure OASI/HI tax rates to reflect reality;
4) Deflate the Consumer Price Index to the extent that current market conditions do not impact on benefit recipients;
5) Tie benefit increases to wages;
6) Avoid interfund borrowing and general revenue financing.

For the long term, a basic restructuring of the whole system is needed. Work should begin today on scaling back replacement ratios which would permit a lowering, or perhaps just no further increase, in the wage base and tax rate. Other steps such as an increase in retirement age to 68 should be adopted as may be necessary to guarantee the long-term financial soundness of the program. And Social Security should be extended to federal, state and local government workers.

STATEMENT BY KENNETH R. AUSTIN FOR THE AMERICAN COUNCIL OF LIFE INSURANCE BEFORE THE SUBCOMMITTEE ON SOCIAL SECURITY, COMMITTEE ON FINANCE

July 10, 1981

I am Kenneth R. Austin, Chairman and Chief Executive Officer of the Equitable Life Insurance Company of Iowa and hold comparable positions with several affiliated life insurance companies. I also serve as Chairman of the Committee on Social Security of the American Council of Life Insurance. With me is Arthur S. Fefferman, Director of Tax, Pension and Social Security Analysis of the Council. We are appearing here today on behalf of the Council which represents 518 life insurance companies. These companies account for 95 percent of the life insurance in force in the United States and 97 percent of the assets of all life insurance companies.

We are particularly pleased that your distinguished Subcommittee is holding this public hearing on Social Security financing. Social Security performs a vital and indispensable function in providing a floor of protection for our older population in the areas of retirement and health and for all our population in the areas of disability and survivor protection. For this reason, it is essential that the system function properly and be financed adequately.

Social Security now faces severe financial problems. The retirement program, OASI, faces acute short-range financial problems which are being accentuated by stagflation which increases benefits and decreases receipts. According to the latest available estimates, unless remedial action is taken, the OASI trust fund could be depleted by the latter part of 1982 when funds could become insufficient to pay the benefits that are due. The system also faces long-run deficits on the basis of what now seems to be the most reasonable economic and demographic estimates. The projected deficits become very substantial in the second quarter of the next century when the ratio of Social Security recipients to active workers will increase to relatively high levels, placing heavy financial burdens on the active workers who support the system.

In view of these conditions, we believe that the OASI trust fund should be authorized to borrow from the Disability Insurance (DI) and Hospital Insurance (HI) trust funds if this is found to be necessary to prevent the retirement fund from declining to inadequate levels. However, actions of this type are merely "band-aids" and provide only temporary short-run relief. They do not resolve the underlying financial problems of the Social Security system and should not be permitted to distract from the basic actions that are required to place the system on a sound financial basis. It is therefore gratifying to note that the Administration and this distinguished Subcommittee recognize the urgency of the situation and are seeking prompt and effective solutions.

We urge that the following basic actions be taken to achieve a financially sound Social Security system. These actions have two major objectives: (1) to provide adequate tax revenue to pay Social Security benefits when they come due and (2) to keep Social Security costs within the limits of the Nation's fiscal capacity by moderating projected sharp increases in benefits.

1. Finance Social Security Through Payroll Taxes, Not General Revenues

We believe that Social Security should continue to be financed solely through payroll taxes paid equally by covered workers and employers. Such payroll taxes enable covered workers and employers to share the cost of the program in a responsible fashion. These taxes have the capability of producing the large sums necessary to finance Social Security. Moreover, they have the virtue of being highly visible, which helps to maintain the vital link between an employee's benefits and his or her contributions.

Social Security payroll tax rates should be set at levels that are adequate to finance reasonable benefits provided by law even if this means having the OASDI-HI payroll tax increase to 7.05 percent take effect in 1983 instead of in 1985 as under present law. Failure to maintain payroll tax rates at adequate levels would require the use of general revenues to finance Social Security. This would be particularly undesirable since, in a very real sense, there is no general revenue available to finance Social Security in view of the large budget deficits confronting us. Accordingly, general revenue financing would reduce confidence in the Social Security system, as it would be widely construed as a sign that we are not willing to face up to the hard issues involved in placing the system on a sound financial basis. Moreover, unless we are willing to accept continued budget deficits with its unfortunate consequences for inflation, the use of general revenues instead of payroll taxes to finance Social Security means that the costs of the system will have to be paid later by other forms of taxes. In other words, to the extent that payroll taxes are not used to finance Social Security, other forms of taxation less suited for this purpose will have to be used.

2. Reform Present Indexing Procedures

We believe that much of Social Security's financial difficulties is due to the great financial drains on the system resulting from present procedures for indexing Social Security benefits. Accordingly, while benefits should continue to be adjusted for inflation in order to preserve their role as a floor of protection and to prevent hardship, a comprehensive review should be made of the present indexing procedures to determine whether they are appropriate in the present circumstances. This review should include an examination of the present Consumer Price Index (CPI) to determine whether it accurately reflects changes in the cost of living for Social Security beneficiaries and whether revisions in the index are needed to avoid overstating increases in such living costs. The present indexing procedure, for example, appears to give undue emphasis to the increased cost of home ownership associated with rises in mortgage interest rates, since the bulk of the Social Security beneficiaries do not purchase new homes.

Moreover, there is a broad question whether the Nation can afford to completely insulate from inflation Social Security beneficiaries, or indeed any other large groups of individuals. One possibility would be to limit the annual increase in Social Security benefits under automatic indexing to a specified percentage of the increase indicated by the CPI. Another possibility would be to limit the annual increase in benefits to the increase in average wages for years when such wages increase less than the CPI.

We also support the Administration's proposal to moderate the increases in initial benefits provided for active workers when they retire. This would be done by increasing the "bend points" in the weighted benefit formula by 50 percent instead of 100 percent of increases in average wages in the years 1982-87. This change would provide benefit levels for new cohorts of beneficiaries which would be compatible with the financial position of the Social Security trust funds. It would restore replacement rates to the levels generally prevailing in the 1960s and would provide an initial replacement rate of 38 percent for the average worker.

Similarly, we endorse the Administration's proposal to place the automatic increases in benefits on a fiscal year basis by deferring the date for such increases from June to September, based on the changes in the CPI over the full year beginning in July and ending in June.

3. Increase the Retirement Age Under Social Security Gradually, After Sufficient Advance Notice

We believe it essential to provide now for a gradual increase in the retirement age under Social Security after giving individuals sufficient advance notice to adjust their retirement plans. Americans are now living significantly longer and are generally able to work until a later age than they did in 1935 when the earliest retirement age for the receipt of benefits was set at 65. As life expectancy becomes longer, it is appropriate to reapportion an individual's life span between years of work and years of employment. The Age Discrimination in Employment Act, as amended in 1979, recognizes this by generally prohibiting mandatory retirement prior to age 70.

Unless the retirement age is increased, the future will see substantial increases in the relative size of the retired population and relatively smaller numbers of active workers to carry on the Nation's productive process. This change will be especially marked in the early part of the next century when the front end of the post-World War II baby boom will begin to reach 65. At present, there are about 20 persons age 65 or over for each 100 persons at the working ages, 20-64. According to the most recent intermediate estimates of the Social Security Administration, this "retirement-dependency ratio" will increase only moderately over the next 25 years, but will then climb sharply, reaching a high of 38 in 2030 and thereafter.

Social Security should recognize these important demographic and social developments. A gradual increase in the minimum retirement age for receipt of full benefits would help to stabilize the financial position of the Social Security system and would avoid placing undue financing burdens on the working population. For example, an increase in the normal retirement age under Social Security, which begins to take effect gradually after a long notification period to avoid any possible hardship, would greatly reduce the ratio of retirees to active workers in the next century and would eliminate about two-thirds of the long-term (75-year) average deficit projected on the basis of the intermediate assumptions of the 1980 Trustees Report.

We, therefore, suggest that the normal retirement age be kept at 65 until the year 2000 and that thereafter it be increased by one-fourth of a year annually until a retirement age of 68 is reached for 2012 and later years. At the same time, the early-retirement age, at which reduced Social Security benefits are payable (now 62) would be increased to 65 in corresponding gradual increments, again starting the upward movement at about the turn of the century. As an alternative, age 62 could be kept as the earliest retirement age with an actuarial adjustment in the size of the benefit for retirement prior to age 68, the new normal retirement age. This would give the public a long advance notice of the changes and yet have the new normal retirement age be fully effective when most needed--when the members of the World War II baby boom population begin to retire, early in the next century.

We endorse the concept underlying the Administration's proposal to reduce the benefits of early retirees since it is consistent with a general increase in retirement age. However, we strongly believe that it would be preferable to put such a proposal into effect as part of an overall plan to raise the normal retirement age under Social Security to 68, as under our recommendation. Moreover, it is important that the proposed reduction in benefits for early retirement not be put into effect abruptly. Instead, it should be phased in gradually over a sufficiently long period of time to give future retirees sufficient advance notice to permit them to adjust their retirement plans. Such advance notice, in our opinion, is essential in order to avoid hardship and to gain public acceptance.

For similar reasons, we support two Administration proposals that are also designed to encourage later retirement under Social

Security--namely a proposal to change the benefit computation point from age 62 to 65 and a proposal to eliminate childrens' benefits for retired workers age 62-64--again, provided that there is sufficient advance notice of the change to give individuals time to adjust their retirement plans.

4. Retain the Retirement Test for Social Security Benefits

While we sympathize with the objective of encouraging older individuals to work, we do not support the elimination of the retirement test, which would allow all otherwise eligible individuals to receive full Social Security benefits regardless of the amount of their earnings. This test is essential to the concept that the function of Social Security is to provide retirement benefits as a partial replacement of wages. Elimination of the retirement test would convert Social Security to a system which pays annuities to eligible individuals, regardless of whether they retire or continue to work. This would result in payment of benefits to individuals who do not need them as a replacement of earnings and would increase Social Security expenditures at a time when we should be considering every means of reducing them.

5. Eliminate Windfall Benefits and Move Toward Universal Coverage of Government Employees and Employees of Nonprofit Organizations

We support elimination of the windfall benefits received under Social Security by former government employees and employees of nonprofit institutions who have spent most of their working careers in noncovered employment but who acquire sufficient coverage to qualify for Social Security benefits. Present law gives such individuals unintended advantages in allowing them to receive the advantages of the heavy weighting in the present benefit computation formula which is intended for and should be confined to long-term low-income employees. Both equity and fiscal considerations strongly favor the elimination of the windfall elements in such benefits.

Moreover, eventual universal coverage under Social Security should be provided for all government employees and employees of nonprofit organizations in a way which assures that present employees who spend their entire careers in such employment do not have less overall benefit protection.

Finally, the option of State and local governments and nonprofit organizations to withdraw from coverage should be eliminated, after a grace period, during which the filing of notices of intent to withdraw would be permitted.

6. Extend the Family Cap Now Applicable to Disability Benefits to Retirement and Survivor Benefits

The Administration's proposal to extend the family maximum cap that is now applicable to disability cases to retirement and survivor cases merits support. The 1980 disability amendment limited the maximum family disability benefits to the lesser of 85 percent of the worker's average index earnings or 150 percent of the primary benefit, but not less than 100 percent of the primary benefits. Extending a similar maximum to old age and survivor family benefits would help assure that such family benefits will not exceed the worker's previous net take home pay and put the worker's family in a better financial position when he retires than when he worked.

7. Adopt the Administration's Disability Insurance Proposals

We support the Administration's recommendations to relate Disability Insurance (DI) more closely to an individual's work history and medical condition and to prevent excessive benefits. This includes:

a) Assuring that DI benefits will not be awarded to persons with temporary disabilities by requiring an individual's disability to have lasted or to be expected to last 24 full months;

b) Restoration of the six month waiting period requirement in effect prior to 1972, thus conforming to the terms of most private disability programs;

c) Requiring individuals to have been in covered employment for a minimum of 6 out of the 13 quarters prior to disability and 30 out of the 40 quarters prior to disability in order to qualify for DI benefits. This change would make DI benefits more compatible with their role as a replacement for recently lost wages than the present requirement for coverage in 20 out of the past 40 quarters which makes it possible for a person to be out of covered employment for as long as five years and still qualify for DI benefits; and

d) Providing an appropriate "megacap" to limit related disability benefits to a total amount that is not excessive in relation to the previous after-tax earned income.

8. Reduce Pressures on Social Security by Maintaining a Favorable Environment for Voluntary Pension Plans and Private Savings

Finally, pressures for placing increased financial burdens on Social Security should be reduced by maintaining a favorable environment for the growth of voluntary pension plans and other private savings for retirement. It is widely recognized that the historic purpose of Social Security is to provide a basic floor of protection and that voluntary private pensions and other private savings have the job of supplementing this basic floor. To the extent that such private retirement savings are encouraged through appropriate tax measures--such as raising the tax deductible limits for contributions to IRAs and H.R. 10 plans and allowing employees covered by pension plans to participate in IRAs and to deduct their own contributions to pension plans, within the IRA limits--demands for costly expansion of Social Security benefits are reduced, and provision is made for the capital formation that is essential for a dynamic economy with stable price levels.

This concludes our specific recommendations. Before closing my remarks, I want to emphasize again that, in view of Social Security's vital importance to our older people and the Nation, we cannot afford to risk weakening it by continuing expenditure patterns that substantially outrun receipts. We urge you to take prompt action to bring these expenditures and receipts into balance and thereby place Social Security on a sound financial basis, both in the short run and over the long range.

From: American Council of Life Insurance
1850 K Street, N.W.
Washington, D.C. 20006
Contact: Charles Barbour
Phone: (202) 862-4065

July 10, 1981

FOR IMMEDIATE RELEASE

PROMPT ACTION URGED TO SHORE UP SOCIAL SECURITY

Washington, July 10 -- Because the Social Security system now faces severe short-run and long-range fiscal problems, prompt remedial action is necessary to put the system on a sound financial footing, the Subcommittee on Social Security of the Senate Finance Committee was told today.

Testifying before the Social Security Subcommittee on behalf of the American Council of Life Insurance, Kenneth R. Austin, chairman and chief executive officer of the Equitable Life Insurance Company of Iowa, said that "according to the latest available estimates, unless remedial action is taken, the retirement trust fund could be depleted by the latter part of 1982."

"The system also faces long-run deficits, especially in the second quarter of the next century when the ratio of Social Security recipients to active workers will increase to relatively high levels, placing heavy financial burdens on the workers who support the system," he said.

Mr. Austin, who commended the Reagan administration and the Subcommittee for recognizing the urgency of the situation and for seeking prompt and effective solutions, urged that eight basic actions be taken to achieve a financially sound Social Security system.

These actions, he said, have two major objectives: "(1) to provide adequate tax revenue to pay Social Security benefits when they come due; and (2) to keep Social Security costs within the limits of the Nation's fiscal capacity by moderating projected sharp increases in benefits."

The eight steps he outlined are:

-Continue financing Social Security solely through payroll taxes paid equally by covered workers and employers. "Payroll tax rates should be set at levels that are adequate to finance reasonable benefits provided by law even if this means having the OASDI-HI payroll tax increase to 7.05 percent take effect in 1983 instead of 1985," Mr. Austin said.

-Reform present indexing procedures. Because many of Social Security's fiscal problems are due to the great financial drains on the system resulting from present methods of indexing Social Security benefits, a thorough review of indexing procedures should be undertaken to determine whether they are still appropriate, Mr. Austin told the Subcommittee. This review should include a close look at the Consumer Price Index (CPI) to see if it accurately reflects changes in the cost of living for Social Security beneficiaries. In addition, consideration should be given to limiting the annual increase in benefits to a specified percentage of the CPI or limiting the yearly increase to the increase in average wages for years when wages go up less than the CPI, Mr. Austin said.

-After giving sufficient advance notice, gradually raise the retirement age to 68. Starting in the year 2000, Mr. Austin testified, the retirement age should be increased by ¼ year annually until a retirement age of 68 is reached for 2012 and later years. At the same time, the early retirement age (now 62) should be raised to 65 in gradual increments, starting at the turn of the century.

-Keep the retirement test for Social Security benefits.

While stressing that the life insurance business sympathizes with the objective of encouraging older people to work, Mr. Austin told the Subcommittee that "elimination of the retirement test would convert Social Security to a system which pays annuities to eligible individuals regardless of whether they retire or continue to work. "This," Mr. Austin said, "would result in payment of benefits to individuals who do not need them" and "would increase Social Security expenditures" when we should be reducing them.

-Eliminate windfall benefits and move toward universal coverage of government employees and employees of non-profit organizations.

- more -

"Present law," Mr. Austin told the Subcommittee, gives former government employees and non-covered employees of non-profit institutions "unintended advantages" which are meant for and should be confined to "long-term, low-income employees."

-Enact the Administration's proposal to extend the family cap now applicable to disability benefits to retirement and survivor benefits.

-Adopt the Administration's disablity proposals. "We support the Administration's recommendations to relate Disability insurance more closely to an individual's work history and medical condition and to prevent excessive benefits," Mr. Austin told the Subcommittee.

-Reduce pressure on Social Security by maintaining a favorable environment for voluntary pension plans and private savings.

"To the extent that private retirement savings are encouraged through appropriate tax measures -- such as raising the tax deductible limits for contributions to IRAs and H.R. 10 plans and allowing employees covered by pension plans to participate in IRAs and to deduct their own contributions to pension plans, within the IRA limits -- demands for costly expansion of the Social Security system are reduced, and provision is made for the capital formation that is essential for a dynamic economy with stable price levels," Mr. Austin said.

"In view of Social Security's vital importance to our older people and to the nation," Mr. Austin told the Senators, "we cannot afford to risk weakening it by continuing expenditure patterns that substantially outrun receipts.

"We urge you to take prompt action to bring these expenditures and receipts into balance and thereby place Social Security on a sound financial basis, both in the short run and over the long range."

###

WPC, FSC, NML
TPL, TPX

[Whereupon, at 2:45 p.m., the hearing adjourned, subject to the call of the Chair.]

○